LAW AND CONTEMPORARY PROBLEMS

STATE TRADING
PART I

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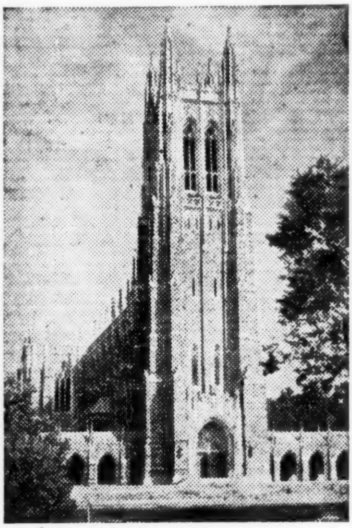

THE CHAPEL

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LAW AND CONTEMPORARY PROBLEMS

Volume 24 SPRING, 1959 Number 2

FOREWORD

State trading—the government conduct or control of commercial intercourse—is an institution whose roots reach many centuries into the past. Thus, it was practiced extensively during the Middle Ages—most notably, perhaps, by some of the city-states of Italy. With the advent of the mercantile revolution, however, and the ensuing ascendancy of a "laissez faire" philosophy, state trading passed into relative eclipse, to reappear only fitfully and apologetically, from time to time, as a somewhat distasteful wartime expedient, or as a minor revenue-producing mechanism.

But this abject posture of state trading was radically revised by the Russian Revolution. In conjunction with state production, state trading was unequivocally embraced by the Soviet Union as an integral element of its all-encompassing economic planning system. As such, it was conceived of only as one of a battery of measures designed internally to strengthen the infant regime against the hostile forces that were threatening from within and without, and ultimately to bring about the evolution of a communist society.

These rather parochial functions, however, did not more than faintly foreshadow the potential effectiveness of state trading as an instrument of foreign policy. And, indeed, it was not until after the conclusion of World War II that the Soviet Union and its communist cohorts sought systematically to bend state trading to the achievement of broader international ends. Only since then has state trading registered any significant impact on and become a matter of other than mere academic interest and concern to the general public.

Whether this late re-emergence of state trading is good or bad in an absolute sense is a matter of some dispute. Undeniably, its strength, flexibility, and sensitivity to the total needs of the state render it, on the one hand, an efficient means of directing and regulating national development, as well as a powerful weapon for economic penetration and political subversion. But on the other hand, it unquestionably inhibits competition, effects a misallocation of resources, and distorts patterns of production and consumption. In either event, however, state trading is now a well-entrenched, burgeoning phenomenon in a large part of the world. Accordingly, since more extensive contact between state and private-trading systems is probably inevitable, if not desirable, an exploration of some of the difficulties entailed in

attempting to accommodate their disparate features and further inquiry into some of the solutions that have been propounded would seem to be indicated.

Of the many problems that have been generated by the collision between the two systems, perhaps one of the most delicate involves the question of whether a state-trading instrumentality should be exempted from the legal liabilities to which similarly-functioning nongovernmental entities are subject. Although tradition would suggest an absolute immunity, it has widely and cogently come to be recognized that such an approach may well be irrelevant in an age that is witnessing a proliferating state invasion of sectors that customarily have been considered private. Doctrinally, the United States and Great Britain seem to have lagged somewhat, but there is, nevertheless, even in these states, a discernible general trend toward the formulation of and adherence to a more realistic, qualified—albeit rather vaguely-defined—concept of sovereign immunity that would juridically equate certain state activities with those of private persons.

Another manifestation of this tendency more closely to assimilate state and private-trading operations may be seen in the increasing use of arbitration for the settlement of disputes arising out of transactions to which states or their instrumentalities are parties. This, too, is a healthy development, but it can be furthered only so long as the arbitral bodies preserve their integrity and continue to inspire confidence in the impartiality and legality of their dispositions.

Repercussions of state trading also have been felt in the international monetary and several other areas. To ease or possibly avoid these many conflicts, efforts have been made on an international level to generalize and give a multilateral structure to a number of fundamental principles. Success to date, however, has been very limited, and, in cold fact, seems quite unlikely of future attainment. Perhaps, as has been intimated, international law and relations in this field will develop mainly in a series of *ad hoc* compromises, out of which a body of generally-accepted rules may eventually take form.

These are some of the more salient aspects of state trading to which our contributors have directed their attention in this issue. If their general thrust seems to be predominantly theoretical, it is expected that this will be counterbalanced in part two of this symposium, which will appear in the next issue, in which a survey of state trading in practice will be undertaken. Together, it is hoped that these issues, although by no means comprehensive or definitive in their treatment of the subject, will facilitate a sound evaluation of state trading on the contemporary scene and thus, perhaps, in a small way, conduce an effective response to the profound challenge it is offering the Western world.

MELVIN G. SHIMM.

STATE TRADING IN HISTORY AND THEORY*

JOHN N. HAZARD†

State conduct of foreign trade is a major concern of midcentury economists, lawyers, government officials, and private merchants. Its most ardent opponents have suffered defeats, and even the United States Government is considering resort to it as an instrument of the cold war. Writing in December 1958, James Reston, of The New York Times, has found it possible to quote an anonymous high official in Washington in a warning,[1]

> We have been discussing quietly inside our own Government for six months the need to establish an overseas trade monopoly to compete with the Soviet monopoly on equal terms, but this is so foreign to our normal way of doing business that we dare not mention it in public.

International conferences of governments[2] and of individual scholars[3] have been wrestling with the unresolved problems presented by the expansion of state trading. The concern of theoreticians and practical men alike is mounting, and the problems are many, as evidenced by the articles in this symposium devoted to the subject. What began to be important years ago, but without attracting attention, has been brought since World War II to the front lines of the clash of ideologies between the private-enterprise economies and those flying the flag of communism. Today, officials even of the major bastion defending the private-enterprise system are contemplating risking a hole in the walls to compete more effectively with Soviet traders seeking to expand the influence of the Soviet Union and of Communist China throughout the world.

The problems of today are far from those of the early Middle Ages, when state trading may be said to have been born. An economist has written that, "the trade of Venice was organized upon a political basis. It could almost be said that the Venetian state was a company of merchants of whom the Doge was the chief."[4]

The history of the intervening centuries[5] is not the concern of those seeking

* The author wishes to express appreciation for bibliographical aid in the preparation of this article rendered by Dr. Martin Domke, of the American Arbitration Association, and Miss Ruth Savord and Mr. Donald Wasson, of the Council on Foreign Relations in New York.

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[1] Reston, *Trade Policy Quandary,* N.Y. Times, Dec. 2, 1958, p. 17, cols. 3-5.

[2] See U.N. Doc. No. E/ECE/270, pt. I (1957).

[3] See HAROLD J. BERMAN, MEETING OF JURISTS ON PEACEFUL COOPERATION, FINAL REPORT (Doc. No. UNESCO/SS/Coop/Inter 1, annex III) (1958).

[4] HUNTLEY M. SINCLAIR, THE PRINCIPLES OF INTERNATIONAL TRADE 14 (1932).

[5] See CLIVE DAY, A HISTORY OF COMMERCE (4th ed. 1938); also ASHER ISAACS, INTERNATIONAL TRADE, TARIFF, AND COMMERCIAL POLICIES (1930).

a trace of state trading, for they witnessed the predominance of private merchants, working to further their private interest through devices such as the fairs, the Hanseatic League, and finally the great companies with fighting forces and quasi-sovereign power. The state taxed and even designated the regions of trade. Its explorers opened new continents, and its galleons protected the trade routes; but it was not itself the monopoly buyer and seller with which state trading is today associated. It was not until the industrial revolution had become far advanced, with the attendant concern of economic theorists for new methods to cope with its aftermath, that state trading appeared as a panacea. It was linked with other elements of a strengthened state in the minds of those who called themselves socialists, as part of their plan for economic development under state auspices. The disciples of "laissez faire" remained so numerous, however, and the expanding capitalist economy so fruitful that it was the scholar, and not the government official, who bothered with such ideas.

World War I brought an end to many dreams, among them the possibility of winning a war without mobilizing the key elements of the economy as well as its military forces. Englishmen and finally Americans had to abandon their concept of "laissez faire" in certain areas to meet the demands of the crisis. Economists have noted that familiar views persisted, but practice changed perceptibly, so that the state's role was enlarged, despite formal obeisance to liberal principles.[6] Purchasing missions on government account appeared in the great markets of the world. The Tsar of Russia bought munitions in the West, and the firm of Morgan financed the French Government in its commercial operations in the United States. The retreat from private enterprise was not limited to the Continent. The United States thought it necessary to requisition the railways and to form a commercial fleet to be managed by the War Shipping Board. Yet, governments still relied upon the price system to obtain the goods they required. The War Shipping Board waived its right to claim sovereign immunity in the courts.[7] "Business as usual" is said to have "expressed not only one's patriotic duty, but also abounding faith in the transitory character of the whole episode."[8]

With the ending of World War I, the popular slogan of the time was "back to normalcy," and for the Western world, state trading was laid to rest as a necessary evil of wartime, to be discarded as soon as international trade could be restored to the long-proven methods of the private merchant, moving alone or in concert with his fellows, about the markets of the world. State trading reverted to secondary consideration, as an inconsequential mechanism of the commerce of the world, useful to some nations seeking revenue for depleted treasuries through tapping the pockets of salt-eaters, liquor-drinkers, and smokers via almost traditional state monopolies

[6] See NORMAN S. BUCHANAN & FRIEDRICH A. LUTZ, REBUILDING THE WORLD ECONOMY: AMERICA'S ROLE IN FOREIGN TRADE AND INVESTMENT 27 (1947).

[7] See The Florence H., 248 Fed. 1012 (S.D.N.Y. 1918).

[8] BUCHANAN & LUTZ, *op. cit. supra* note 6, at 27.

of salt, liquor, tobacco, and matches. State trading was not generally expected to be important on any grander scale.[9]

Into this commonly-accepted school of thought, which viewed state trading as an instrument in the arsenal of war, except for the occasional revenue-producing tobacco, salt, or liquor monopoly, was thrust quite a different theoretical approach by the Russian Revolution of 1917. At first, the new approach caused little alarm. The whole revolution seemed to be a transitory phase, which could be quarantined until it collapsed of its own weight or was conquered by elements loyal to the prerevolutionary regime, helped at places by the Western powers.

Vladimir Ilyich Lenin, as the theoretician of the Russian Revolution, set the stage for what was to follow. He declared,[10]

> Strengthen and regulate those state monopolies, which have already been put into effect and then prepare the monopolization of foreign trade by the state; without this monopolization we shall not be able to separate ourselves from foreign capital and from paying tribute.

In this concept, state trading became a companion of state production. Both seemed necessary to Lenin to achieve an economic organization suitable to the creation of a socialist and ultimately a communist society.

Lenin was not unchallenged, even within his own Communist Party, for some of his colleagues thought that in the early stages of the new Soviet society, the new Soviet state could protect its infant state industries as other nations protected their infant private industries—namely, by high tariffs. He lashed out at Nikolai Bukharin to say,[11]

> Bukharin does not see that no policy of tariffs can be effective in the imperialist epoch when there is a monstrous difference between the poor countries and those of unbelievable wealth. Bukharin refers to protection by tariffs, failing to see that under the conditions referred to any one of the wealthiest countries can break down this protection.

The spectre of a giant cartel willing to sell its goods in the Soviet market at cut prices so as to dominate the new Soviet state producers, even under a tariff set at previously unimagined heights, haunted Lenin. Fearful as he was that the capitalists sought not only to expand sales in the new Soviet market, but even to undermine the Bolsheviks by weakening their economic power, Lenin was strong in his determination to foster state trading. He was doing more than protecting infant industries. He was preparing the way for an infant society which he expected eventually to mature so as to win domination of the world. In this situation, state trading was an instrument of the new Messiah, and its place in the Soviet arsenal of

[9] Jacob Viner has expressed doubt that the League of Nations' Committee for the Study of the Problem of Raw Materials (1937) acted properly in excluding examination of tobacco monopolies because they fell within the sphere of internal policy. He thinks the purchasing practices of fiscal monopolies which are important purchasers of foreign commodities legitimate subjects of concern to other countries. See JACOB VINER, TRADE RELATIONS BETWEEN FREE-MARKET AND CONTROLLED ECONOMIES 71-72 (League of Nations Pub. No. 1943. II. A. 4).

[10] 22 V. I. LENIN, SOCHINENIIA [COLLECTED WORKS] 449 (3d ed. 1928-37).

[11] 27 *id.* at 381.

weapons was protected with all the emotion of one whose aim was world salvation, not the narrower goal of economic profit. Only in this light can the Leninist position be evaluated. No concession to Soviet power would loom large enough in Lenin's eyes, nor in the eyes of those who have followed him, to be worth even partial abandonment of the state monopoly of foreign trade.

It is against such a background that state trading was created by law as one of the pillars of the new Soviet state. Lenin's decree of April 22, 1918 declared,[12]

> All foreign trade is nationalized. Contracts for the purchase or sale of all kinds of products (the products of mines, of industry, of agriculture and others) with foreign governments or individual enterprises abroad will be carried out in the name of the Russian Republic by specially empowered organs. Apart from these organs every contract for trade, for purchase or sale abroad is forbidden.

Stalin repeated Lenin's adamant position in defense of state trading at the height of the New Economic Policy when an American delegation asked why he felt it necessary to adhere to it at the same time that a neocapitalism had been authorized for the domestic economy. In his retort, he said,[13]

> the abolition of the monopoly of foreign trade would mean a retreat from the industrialization of the country, from the construction of new plants and factories, from the repair of new plants and factories. This would mean for them the submergence of the U.S.S.R. by goods from capitalist countries, the warping of our industry by virtue of its relative weakness, an increase in the number of unemployed, a decline of the material position of the working class, and a weakening of its economic and political position.

Stalin was thinking still in terms of protection of the new Soviet system from enemies from without. He had not yet had the vision of state trading as a mighty weapon in the struggle for men's minds throughout the world. When he sold lumber or coal at dumping prices in foreign markets, he sought to get much-needed foreign exchange so that he might buy precious foreign machines to modernize his factories. He was not seeking to enter the foreign markets with a wedge to be expanded later by political methods when the time was ripe. Not until after World War II did this possibility open to Soviet leaders, to be exploited by Nikita Khrushchev with such effectiveness that state trading became of concern not only to private merchants seeking to save their hard-earned places in foreign markets, but to foreign office officials seeking to maintain alliances or to encourage neutrality in the mid-century conflicts conducted on the governmental level to win friends.[14]

For the private-enterprise countries entering upon the interwar years, state trading was as strongly opposed by the vocal elements as it was praised by the Soviets. Private commerce between nations had to be restored to vigor. In this process, the state had a duty to seek out markets for its merchants, even to create commercial

[12] [1918] Sob. Uzak. RSFSR, No. 23, item 432.

[13] J. V. STALIN, *Conversation with the First American Workers' Delegation, Sept. 9, 1927*, in VOPROSY LENINIZMA [QUESTIONS OF LENINISM] 179 (10th ed. 1933).

[14] For an account of Soviet policy, as evidenced by trade statistics and reports, see JOSEPH S. BERLINER, SOVIET ECONOMIC AID: THE NEW AID AND TRADE POLICY IN UNDERDEVELOPED COUNTRIES (1958).

counselors in its embassies abroad to study markets and report back to boards of trade and departments of commerce what seemed to be a good place to sell or to buy. Yet, this was not state trading. The United States Government was not itself to buy olive oil in Italy for sale in New York on the open market.

This view of the desirability of state withdrawal from participation in foreign commerce, except as an aid to private merchants, was shaken, however, with the Depression. There appeared practical men who began to think of state trading not in Soviet terms of a means to further state absorption of the domestic producer and in aid of state economic planning, but rather as a means of improving comparative advantage in international trade. Bulk buying was seen as a means of obtaining low quotations from producers dazzled by enormous orders. State trading provided the opportunity to increase the size of the orders placed abroad. In a world in which currencies were becoming blocked in increasing numbers, state trading facilitated the execution of barter deals through which critical materials could be obtained without use of foreign exchange at all. Many decried these departures from the classical form of international commerce, but to these critics there was the reply that the crisis of the Great Depression was as much of a challenge as a war, and departure was justified to save the state. It would be only a temporary expedient until business could be resumed as usual.

A new element entered the debate, however, for in contrast to the war period, there were now analysts who were not so sure that state trading was to be only a temporary expedient. Charges began to be hurled against the state traders of the private-enterprise world that they were but wolves in sheep's clothing. Some critics feared that under the guise of temporary expediency, proponents of state trading were seeking to prepare the way for ultimate introduction of a socialist system which only a small minority would favor if they could understand what was happening.

Into this scene of growing scepticism of expressed motives came World War II. The private-enterprise countries girded for action, and again they turned to state trading, but they sought to avoid some of the practices of World War I. The United States nationalized no railways, although it did requisition ships. This time, private enterprisers were, wherever possible, to remain as administrators, and the state was to serve only as coordinator in the war effort, setting priorities, establishing fixed prices, fixing specifications, and even dictating order boards, but not itself being the entrepreneur.

To this policy of restraint, there were exceptions in critical areas.[15] In the United States, the production of synthetic rubber became a state monopoly, and the secret manufacture of atomic fuels was, of course, a state activity. In the foreign trade area, the state also found it necessary to participate directly to keep critical materials from the hands of the enemy when these materials appeared on foreign markets.[16]

[15] See STEPHEN ENKE & VIRGIL SALERA, INTERNATIONAL ECONOMICS 437 *et seq.* (1951).

[16] See FOREIGN ECONOMIC ADMINISTRATION, REPORT TO CONGRESS ON OPERATIONS 15 (1944).

Only a government could function in the neutral Turkish market to keep the Germans from buying hazel nuts from which they could extract precious oil for mechanical fuses. Each of the foreign powers buying in the American market to equip their military machines created purchasing commissions which acted for the state in obtaining the sinews of war.

The United Kingdom established a pattern with its United Kingdom Commercial Corporation, through which it conducted preclusive buying operations to hamper the enemy, and with its British Purchasing Commission in Washington, it created a headquarters for its war purchasing effort, as did the other allied powers. The last of these to be formed was the Government Purchasing Commission of the U.S.S.R. in the U.S.A.[17]

Those who had studied Soviet practices saw in this last something of a different organization than the agencies called purchasing commissions created by the other powers. Ever since United States recognition of the Soviet Union in 1933, the Soviet authorities had been hoping to establish in the United States an agency similar to that established in most other countries with which the Soviet Union had diplomatic relations—namely, a state-trading delegation. This desire had been resisted by United States Government authorities because it would have involved recognition of some measure of diplomatic status for the commercial agents of the Soviet Union who would comprise its staff. In every country in which Soviet state-trading delegations had been established, the Soviet authorities had requested diplomatic standing for the chief of the delegation, immunity of the premises, the right to use cipher, and immunity from suit. In each case, the establishment had been completed under the terms of a commercial treaty setting forth the extent to which the receiving power was willing to accede to Soviet requests.[18] The authorities of the United States wanted none of this, for they felt that the delegation would be an entering wedge for state trading within the American market, and they feared that pleas of immunity might create a situation from which American merchants could be exploited.[19]

In view of United States Government refusal even to consider the presence of a Soviet trade delegation in Washington, the Soviet authorities had been forced to content themselves with continuation of a device established in 1924, during the period of nonrecognition of the Soviet Government, to serve as an agency through which trade with the Soviet Union could be carried on. It took the form of a New York corporation, entitled the Amtorg Trading Corporation, in which Soviet Foreign Trade Ministry officials held all the stock, but which, as a domestic corpora-

[17] For an account of the United States-Soviet Union relationship, see E. R. STETTINIUS, JR., LEND-LEASE, WEAPON FOR VICTORY cc. 19-20 (1944).

[18] For examples of the provisions of such treaties, see T. A. TARACOUZIO, THE SOVIET UNION AND INTERNATIONAL LAW 182, 183 (1935).

[19] An example of nongovernmental thinking at the time of recognition of the Soviet Union by the United States is to be found in AMERICAN FOUNDATION, THE UNITED STATES AND THE SOVIET UNION: A REPORT ON THE CONTROLLING FACTORS IN THE RELATION BETWEEN THE UNITED STATES AND THE SOVIET UNION (1933).

tion, was subject to all New York laws. There could be no thought of immunity, either in court or to state or federal regulation.

The war situation presented the Soviet Government with an opportunity for change. They began their purchasing for war purposes in the United States after the German attack upon them. As a result of the German attack, the prohibitions of the Hitler-Stalin Pact era were lifted in the United States, and the Amtorg Trading Corporation began to function vigorously again. When the Soviet Union was declared a beneficiary of the Lend-Lease Act on November 7, 1941 by President Franklin D. Roosevelt,[20] the Amtorg mechanism soon evidenced its inadequacy for the new, greatly increased supply task which it was called upon to perform. Edward R. Stettinius, as Lend-Lease Administrator, called in the Amtorg officials, together with the officials of the Soviet Embassy, and advised that a purchasing commission more nearly in the form of those established by the other allied powers be created so that there might be within it Army and Navy supply officers, and not just the peacetime commercial agents of the Soviet Ministry of Foreign Trade. The last had shown themselves incapable of casting aside the peacetime restrictions placed upon them by strict Soviet laws requiring minute inspection of every item and unceasing negotiation for lower prices; yet, a less commercial attitude was necessary if the goods were to be moved swiftly in the vast quantities required by war.

Soon after the establishment of the new Soviet Government Purchasing Commission in Washington, a Soviet Major General of the Air Force and a Soviet Vice Admiral who was a specialist on munitions arrived to assume its direction, but some of the former Amtorg officials remained at their sides. All were subordinate to the long-time specialist on foreign trade in Moscow—namely, Anastas Mikoyan—and he soon tried out his luck. He sent his subordinates to see Mr. Stettinius with the request for information as to whether it could be anticipated that the Purchasing Commission might become after the war a Soviet state-trading delegation. After consultation with the permanent United States Government agencies concerned with peacetime commerce, Stettinius had to inform his questioners that it was not anticipated that the United States Government would look with favor after the war upon the establishment of any state-trading delegations in the United States, and the matter was not raised again.

While indicating its dislike of state-trading mechanisms, the United States Government found itself drawn increasingly into such operations. To conduct its preclusive buying operations in concert with the British, it created a United States Commercial Corporation.[21] This state-trading agency was assigned the task of buying essential raw materials available in countries accessible to Germany—namely, Turkey, Spain, and Portugal. For administrative purposes, it was made subordinate to the Board of Economic Welfare, and as such, it was transferred to the Office of Economic

[20] 55 STAT. 31 (1941).

[21] See HENRY CHALMERS, WORLD TRADE POLICIES: THE CHANGING PANORAMA, 1920-1953, at 273 (1953).

Warfare when the Board was abolished in 1943. Later in the same year, it passed to the Foreign Economic Administration when the Office of Economic Warfare was absorbed by it.[22]

Not all state trading was in the hands of the United States Commercial Corporation, for by Executive Order of May 30, 1942, issued under the First War Powers Act, the authority previously limited to the Secretary of the Navy to make emergency purchases of war materials abroad and to have them admitted to the United States free of duty was extended to various departments and agencies of the United States Government. During the fiscal year 1943-44, $800,000,000 worth of foreign strategic materials were bought with government funds under Foreign Economic Administration direction, exclusive of the preclusive buying program.[23]

The United States Commercial Corporation bought materials for import under War Production Board or War Food Administration directives, and these were then allocated or sold to war industries or for other war purposes, in large part through the facilities of the Reconstruction Finance Corporation and the Commodity Credit Corporation.

The Foreign Economic Administrator, Leo P. Crowley, was kept acutely conscious of the hostility to state trading by the foreign traders and bankers of the United States, and he established an advisory committee of their representatives in an effort to reduce their fears.[24] Almost all of them saw the necessity of war purchases by the state, but many had little confidence in the motives of the Roosevelt administration, which seemed to them to be utilizing the war emergency to establish a foothold for state trading as an entering wedge for socialism. The Administrator's effort to alleviate such fears was reflected in his report for 1944, in which he added a line to his account of the United States Commercial Corporation. He said, "The facilities and services of private importers were utilized at some stage of practically all Foreign Economic Administration procurement operations."[25] Later in the report, he stated that the policy followed in foreign procurement has been to have the United States Government engage in actual procurement only when the required amounts of strategic commodities could not be bought effectively through ordinary commerical channels.

The back was broken by a last straw, which happened to be Italy. As Italy was overrun by allied troops, it seemed obviously desirable to utilize some of her strategic resources by purchasing them for the allied war effort; but it was also desirable from a strategic point of view to aid in restoring the Italian economy so that economic dislocation would not hamper the allied cause among people behind the allied lines. This suggested purchase of other Italian commodities which were useful, but not

[22] For texts of the executive orders concerned, see FOREIGN ECONOMIC ADMINISTRATION, *op. cit. supra* note 16.

[23] See *id.* at 22.

[24] Some of the concerns are reflected in UNITED STATES ASSOCIATES, INTERNATIONAL CHAMBER OF COMMERCE, INCORPORATED, RELATIONS WITH STATE TRADING NATIONS (1948). Also see Chalmers, *State Trading in Europe: Its Status and Prospects*, J. Int'l Economy, Nov. 10, 1945, p. 3.

[25] FOREIGN ECONOMIC ADMINISTRATION, *op. cit. supra* note 16, at 22.

essential, to the strategic stock piles in the United States and the United Kingdom, but for which there was a market which could produce funds with which the Italians could commence rebuilding their war-torn economy.

Under this policy, there were added to the strategic materials a quantity of Italian wines, essential oils, and what the Department of Commerce experts called "a few other Italian specialties."[26] New York private traders were soon reporting that the United States was going so far as to import Italian marble statuettes. These purchases were made by the Allied Commission in Italy and consigned to the United States Commercial Company as its agent. The strategic materials followed the usual pattern of distribution according to War Production Board or War Food Administration order, but the others were distributed among American importers for sale in the open market. The funds obtained by such sales were paid over to the United States for use of the Italian Government, less, of course, the private-trading agent's commission. In this operation, there were the to-be-anticipated charges of favoritism in the allocation of sales agencies by the United States Government to private merchants, and this was held up as a further example of the undesirability of government participation in the foreign trade operation.

President Roosevelt was fully aware of the public relations perils of his state-trading program. He had the Foreign Economic Administrator inform the French Supply Mission and the Colonial Mission in 1944 that they were expected to deal increasingly with private interests in the United States instead of with the United States Government.[27] Prior to that time, the Lend-Lease procurement channels for nonmilitary items, most of which were under the Treasury Procurement Agency of the United States Government, had been buying some nonwar items for the French on a cash-reimbursable basis. This type of activity was to stop, and to make it possible to return to private channels, the Foreign Economic Administration announced in December 1944 that for similar commodities and when the end use was comparable, no preference or higher priority would be given to export license applications from foreign purchasing missions than to applicants from the trade.[28] This restored the American private exporters to business, for up to that time, a foreign government purchasing mission's application would have been given priority automatically.

President Roosevelt, in September 1944, showed his concern for private traders' sensibilities when he released an instruction that after the defeat of Germany, the Foreign Economic Administration "should relax controls over exports to the fullest extent compatible with our continuing war objectives . . . with a view to encouraging private trade without interfering with the successful prosecution of the war against Japan."[29] This concern had been fortified by the apparent desire of some governments to carry on bulk buying or to centralize imports in other forms in the postwar period.

[26] See HENRY CHALMERS, WORLD TRADE POLICIES: THE CHANGING PANORAMA, 1920-1953, at 304 (1953).

[27] *Id.* at 306. [28] *Ibid.* [29] *Id.* at 310.

Bulk purchasing had emerged during the latter half of 1944 in fields unrelated to the war.[30] The United Kingdom announced the conclusion of long-term contracts with the governments of Australia and New Zealand for the bulk purchase of the entire exportable surpluses of meats and dairy products of those countries. The arrangements were to run for from two to four years.[31] Nearly similar arrangements were made with Canada, and the British Ministry of Food announced that it contemplated extending this policy to Argentina and other South American countries. The reason was given that the United Kingdom Government was making these bulk-purchase agreements "as part of its policy for safeguarding food supplies for the United Kingdom for the next few years." The British policy was being opposed, however, by some Englishmen because they thought that it would perpetuate undesirable principles of commercial policy at a time when it was unnecessary to replace private firms and competitive importation by governmental operations.

The United States showed its irritation with such a prolongation of state trading by a letter of President Roosevelt, dated September 29, 1944,[32] in which the President directed that in view of the curtailment to be made in war production after the defeat of Germany, plans should be initiated for

> an appropriate cut in the foreign procurement program for strategic and critical materials needed in the prosecution of the war. The adjustment to this reduced program should be made in such a way as to prevent undue and unnecessary financial losses to American taxpayers, to best preserve our foreign relations and to strengthen the foundation for a high level of international trade in the future.

In spite of these protestations, the fact remained that during 1945, the last year of the war, the great bulk of purchases made in the United States by most of the countries of continental Europe was made through the purchasing missions, sometimes as the agents of governmental centralized buying agencies in their home capitals and sometimes as coordinators and expediters of orders of private merchants in their homelands who negotiated the purchases with American private traders but then needed help in obtaining export licenses in Washington.

True to its promise to the American foreign trade fraternity, the United States Government, in May 1946, prepared an order[33] to be presented to the foreign government purchasing commissions of Australia, Belgium, China, France, Greece, India, Italy, Netherlands, New Zealand, Norway, Poland, Portugal, Union of South Africa, the Soviet Union, and the United Kingdom asking them to limit their operations during a transitional period to the procurement of essential civilian commodities. They were to utilize normal trade channels to the maximum extent possible and to bring their purchasing methods into accord with commercial considerations. After the transitional period, they were to liquidate.

[30] See ENKE & SALERA, *op. cit. supra* note 15, at 443-46.

[31] See HENRY CHALMERS, WORLD TRADE POLICIES: THE CHANGING PANORAMA, 1920-1953, at 326 (1953).

[32] *Id.* at 327.

[33] See Release of May 4, 1946, 14 DEP'T STATE BULL. 819 (1946).

The Secretary of State called each group of officials in turn to tell them of the policy decision and to present them with an *aide memoire*. In the case of the Soviet Government, since it was obvious that the Soviet Government would not abandon its state monopoly of foreign trade, the communication added that it was presumed that the Soviet Government would continue to conduct its commercial operations through a centralized agency, but that the United States Government desired that "trade between the United States and the U.S.S.R. should again be carried on by an agency or agencies incorporated in one of the states of the United States as was the case prior to the war."

American policy, in short, required return to the prewar pattern of commercial relations, even for the Soviet Union; and for the latter, it would have to channel its purchases and sales through an agency having the form of a private corporation. Within a short time, The Amtorg Trading Corporation was required to register as an agent of the Soviet Government under the terms of the Alien Registration Act.[34] This identified it as governmental and provided special controls, atlhough it gave it no rights to claim sovereign immunity.

It seemed in 1946, for the moment, as if state trading could be pushed back to its prewar status; but this was not to be. The various East European states, as they were brought successively securely within the Soviet orbit, declared their policy to be that of state trading. One of these, Czechoslovakia, had become a charter member of GATT in 1947 before this policy had been enunciated, and so there was a monopoly state trader within the framework of an organization primarily composed of private traders who permitted themselves to conduct some state trading, but only on a marginal basis.

The expansion of the Soviet-influenced world was bad enough to private enterprisers, but the real blow was to fall from the hands of the private-enterprise countries themselves, for by 1951, an economist was able to write, "The total amount of the world's trade that is carried on directly by governments is substantial, even if we exclude that of the socialized states."[35] He noted that the United States was the only major wheat-exporting country not having a government-trading monopoly in wheat, and that bulk-purchasing agreements were being utilized by governments to acquire agricultural and numerous other types of commodities, especially raw materials important in the country's economy. He noted further that when nationalization of industry occurred, as it had occurred in the United Kingdom in the coal mines, the railways, and the steel industry, purchase and sale were necessarily through state agencies, and there was no reversal of the trend toward state trading to be expected in this area.

No more controversial agency engaged in such activity was to be found than the Argentine Trade Promotion Institute (IAPI). Until its recent liquidation, it conducted the importation of equipment for the state-owned oil business, railways, and

[34] 54 STAT. 670 (1940). *Cf.* 66 STAT. 223, 8 U.S.C. §§ 1301-06 (1952).
[35] JOHN PARKE YOUNG, THE INTERNATIONAL ECONOMY 372 (3d ed. 1951).

other enterprises. It also served as the import agency for the state monopoly of rubber, tinplate, oil, and coal. Its export operations involved purchase of agricultural products from Argentine farmers at low prices for resale on the markets abroad at world prices. It is even alleged that its position was strengthened by preferential exchange-rate terms on some of its transactions.[36] This position had aroused the hostility of foreign private firms attempting to sell in the Argentine market.

The nationalization policies of the United Kingdom and of France have worried another economist,[37] and he has concluded that World War II is bound to have had a more disturbing effect upon the world economy and international trade than World War I. He doubted that the defeated countries of Italy, Germany, and Japan would avoid state control over their economic affairs. He felt that in the countries occupied during the war, the struggle to wipe out unemployment would tempt even the governments firmly committed to private enterprise to assume unprecedented control over business activities and even, on occasion, to take a direct hand in matters affecting foreign trade. He reported that because of these developments, many are of the opinion that the trend toward direct government control over foreign trade is irresistible and that there is no alternative but to accept national controls over foreign trade. He related this to his conclusion that people are no longer willing to suffer persistent depression and mass unemployment passively, so that governments will find themselves forced to take every reasonable and even heroic measures to combat economic depression, on pain of receiving short shrift at the hands of the masses.

This pessimistic view from the point of view of the private traders is shared by other economists. One thought in 1950 that the outgrowth of the industrial revolution had made apparent the need for action in the public interest, sometimes in the form of regulation and control, sometimes in the form of a laying down of rules for private enterprise, and elsewhere in the form of goods and services provided by the government itself.[38] He expected that no theory would underly such extension, except in areas falling under the influence of the Soviet Union, but that in the private-enterprise countries, the extension would be made on pragmatic grounds. In short, to muddle through a crisis, government would take into its hands economic activity, and by degrees, there would be built up increasing areas of state enterprise, including state trading.

To those who view matters in this way, the report of James Reston, that to meet Soviet economic penetration of areas of the world in which Americans have hoped to see political and economic development along the lines of liberal democracy, the United States is beginning to feel the necessity of recreating the United States Commercial Corporation or some similar agency, is alarming. To meet the threat expressed by Soviet state-trading agencies, the United States sees the necessity of

[36] See ENKE & SALERA, *op. cit. supra* note 15, at 306.
[37] See LAWRENCE W. TOWLE, INTERNATIONAL TRADE AND COMMERCIAL POLICY 743-45 (1947).
[38] See P. T. ELLSWORTH, THE INTERNATIONAL ECONOMY: ITS STRUCTURE AND OPERATION 443 (1950).

creating its own. It is a narrow opening to which attention of this nature is now being given, but it cannot but cause fears that through the crack in the door, the wolf may squeeze.

Without a theory like Lenin's, and to cause the containment of that theory to such parts of the world as presently accept it, the United States, as the arch defender of the private trader, seems to feel itself impelled to adopt the instruments of the hostile theory. Will adoption lead to the final victory of state trading, at least in primary essentials, throughout the world? That is the question posed to the exasperated government officials in Washington as they seek to meet the Soviet successes. They want none of what might follow, but they would like to have a stronger weapon to use in their campaign against the expansion of Soviet influence. If they weaken their position against state trading for this utilitarian purpose, can they argue against the bulk purchasing of their allies of the private-enterprise world? In the answers to these questions lies the future of state trading, and with it, the future of private-enterprise commercial relations. This question is posed at a time when conservative governments have been re-emerging in various parts of the world previously thought to be moving toward socialism. The steel industry in Britain has been returned to private hands, as has road transport. France under De Gaulle may have less socialist influences governing her future. West Germany, Italy, and Japan have not moved totally in the direction of state enterprise anticipated soon after the war by the economist cited above. The Eisenhower administration has done much to check governmental development of domestic resources in the United States. To some, the tide toward socialization of the economy seems to have turned,[39] and with it, the possible spread of state trading has seemed less likely than a decade ago. Yet, following upon these reversals of expectation, comes the thought of using Soviet-type weapons to fight Soviet expansion, and the matter is thrown out of balance again. Even without such a possibility, the discussion of the problems set forth in the articles to follow would be crucial to an understanding of the functioning of an important segment of the foreign trade of the world. With such a possibility, the articles take on new importance of unpredictable magnitude.

[39] See Sulzberger, *Socialism Faces a Year of Decision*, N.Y. Times, Dec. 29, 1958, p. 14, col. 4.

STATE TRADING AND ECONOMIC WARFARE

Robert Loring Allen*

Introduction

International trade theory and policy have customarily treated state trading and economic warfare as temporary aberrations from the norm. The "normal" world is one in which each of the many nations strives to maximize output, in part by specializing in the production of items in which it has a comparative advantage, where private interests seeking profits buy in the cheapest markets and sell in the dearest markets. This search for the gains from trade is conducted within the framework of convertible currencies, with automatic mechanisms determining the principal economic variables—exchange rates, prices, income—and carrying the burden of adjustments in the relatively free flow of goods and services across national borders.

This model, of course, exists only in the mind. Historically, however, there have been approximations to it, particularly in the nineteenth century. Some permanent departures from the model have received widespread recognition. Interference with trade in order to foster high-cost but potentially competitive industries has long been acceptable. Discrimination through various forms of exchange controls, including multiple rates, rationing, quotas, and bilateral balancing of trade have become ordinary policies with, in some cases, an economic justification.

State trading, however, has never been fully accepted as one of the standard methods for conducting international trade. Despite its age—state trading came in about the same time taxes did, when governments began functioning—and its incidence—every government trades to some extent—state trading has always been treated as the exception, as a nonconforming device not really within the framework of the doctrines of international economic analysis. Economic warfare, in one or another of its many manifestations, has also been regarded as an abnormality, associated with military warfare or the preparations for it and with the special role and actions of the occasional predatory nation which seeks to better its position at the expense of others.

State trading calls to mind the trading activities of the Soviet Union since the Revolution, and economic warfare the actions of Germany in Southeast Europe in the years immediately preceding World War II. While these are apt illustrations, they by no means illuminate the pervasive nature and timeless character of both

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state trading and economic warfare. Perhaps in these illustrations lies the explanation of why these two phenomena have never been accepted into economic analysis. State trading is the device of a faithless country whose announced goal is the conversion and subversion of the world. Economic warfare, in the German case, was a set of unusually despicable policies designed to subjugate less powerful neighbors.

But even if state trading and economic warfare were once the extraordinary and the bizarre, this certainly is no longer the case. State trading now embraces at least one-fourth of world trade, and the proportion is increasing. With one great bloc of nations dedicated to it and many other nations increasingly adopting forms of economic organization in which state trading is either desirable or necessary, it is apparent that state trading is a permanent part of the international economic scene. It not only has come of age, but it has also become respectable in the eyes of the world. Economic warfare is also a standard procedure employed by every major power. The few spectacular examples of economic warfare, however, such as the German case, have tended to obscure the day-to-day economic jockeying for power, which must be classed as economic warfare, too, since it transcends the use of trade merely for the benefits of the direct gains to be made therefrom.

I

THE MEANING OF STATE TRADING

State trading is by no means crystal-clear in conception, and its ambiguity in operation is even more pronounced. The commonly used technical definition of state trading is trade which is conducted by a government or its agents. This may be elaborated upon to make provision for the government or its agents holding title to exports before transactions and acquiring title to imports. In order unmistakably to distinguish state from private trading, a dividing line may be drawn by specifying that state trading exists when the government, in addition to determining the kind and quantity of goods traded and their geographic distribution, also negotiates with respect to prices and the terms of the transaction.

At first encounter, it would appear that state trading exists only when the government acts both as a political unit and as the active economic decision-maker. This may, however, be too restrictive a definition. It can be argued that there are state controls over foreign trade which are so comprehensive that the transaction, nominally undertaken by private interests, has the same outcome as it would have had if the state itself had been the participant. Trade restrictions and discrimination, direct and indirect, bilateral balancing of trade, payments agreements, exchange controls, and other controls may well be so severe that while private parties may be the negotiators, they are, in fact, acting on behalf of the state. Thus, state trading is not wholly an objective phenomenon, definable in terms of the substantive provisions of the transactions or the organization of trade. Rather, state trading exists

when national, in contradistinction to private, interests are primarily being pursued.

State and private trading share a spectrum with respect to intensity and coverage. At one end of the spectrum, there is no state trading. At the other end, there is nothing but state trading. The former case is rare; nearly every country trades to some extent, even if only for governmental consumption requirements. The United States, except for its surplus-disposal and stockpile policy, exemplifies this position. At the other extreme, however, the Soviet Union, East Europe, and Communist China have a complete monopsony of imports and monopoly of exports. In between are two other forms: a selective monopsony or near monopsony of particular imports, and a selective monopoly or near monopoly of particular exports. The bulk buying of agricultural products practiced by Great Britain and other European countries is an example of the former; state control of exports of primary products, as in Burma, is an example of the latter.

The form of state trading which a country adopts is a function of its national purposes and goals. There are at least four interrelated basic purposes: (1) protection of domestic industries, (2) improvement in the terms of trade, (3) assistance in the maintenance of control over the domestic economy, and (4) the conduct of economic warfare. It must be recognized, however, that state trading is not the only device by which these purposes may be accomplished. Indeed, other policies may be even more efficacious in some instances. Thus, a monopsony of imports may not be the most effective way to protect domestic industry against foreign competition; stringent exchange controls, quotas, bilateral trade agreements, and tariffs, among other policies, which exclude or raise the cost of competing imports, may, instead, be more advisable. Improvement in the terms of trade, likewise, may be accomplished equally well by either selective or comprehensive state trading or by a number of other policies. State trading is certainly one of the easiest methods, however, since it invests the state with substantially more bargaining power than any private trader could attain. As a buyer, the state trader can obtain imports at lower prices than would have to be paid by a competitive buyer; and as a seller, it can command higher prices than an individual seller on competitive markets can obtain.

When the domestic economy is completely controlled, however, state trading is not optional. In centrally planned economies, state trading is the necessary method for conducting trade, because anything other than state trading would expose the system to disruption through trade which was not designed to fit into the over-all program. A country operating under a centralized economic plan must have state trading to support that plan, to import in accordance with the preferences of the planners, and to export in accordance with the planners' view of the capabilities of the economy. Simultaneously, such a country may also use state trading to protect domestic industries and to attempt to improve the terms of its trade.

Since state trading is national in character, it is only natural that it is a basic instrument of economic warfare. With control over a part or all of its trade, a nation may use this power to reward its friends, punish its enemies, to extract economic and political concessions, and to influence decisions not only of trading partners, but also of third countries. State trading, of course, is not the only weapon in the arsenal of economic warfare. Almost any kind of commercial policy can be used in this fashion if a nation so chooses. State trading, however, particularly in its most extreme form of state monopoly and monopsony, has unique advantages not shared by other techniques.

II

The Meaning of Economic Warfare

Before examining the special role of state trading in economic warfare, it is necessary to have clearly in mind just what economic warfare is. No satisfactory definition exists. Specific words have been used to try to denote its various special aspects. Economic aggression, penetration, infiltration, assault, drive, offensive, imperialism, attack, campaign, invasion, incursion, exploitation, and many others are currently in use. These terms all attempt to convey an emotionally adverse judgment both with respect to the act and the actor. The most general term—economic warfare—has been chosen here, with the realization that in so doing, the emotional, as well as the special-case, stigma still remains.

A. Definition

Economic warfare is defined as the conscious attempt to enhance the relative economic, military, and political position of a country through foreign economic relations. Several aspects of the definition require amplification. The action must be purposeful; otherwise, a nation merely in pursuit of the benefits of trade would be considered engaging in economic warfare if the action should improve its relative position. Economic warfare does not imply success. Rather, it is the attempt that counts; a nation may fail, and its action may have the reverse result.

Stress must be placed on the term "relative." It is the position of a country in the hierarchy of power, its position in relation to other countries, rather than an absolute accretion to power, which is relevant. It matters not whether this is accomplished by a country which gains more than other countries gain, or gains while other countries make no gain, or loses while other countries are losing more. Further, time and space are crucial elements in economic warfare. Thus, a country may, under certain circumstances, estimate that a short-run gain will more than offset a long-run loss. Likewise, a country may absorb a short-run loss in position if it anticipates that in the long run, the actions will improve its position. A country may also willingly take a loss in one area if the gain in another is sufficiently great.

Although economic warfare serves three principal purposes—economic, political, and military—it should not be thought that these are mutually exclusive. All may

be pursued simultaneously, and all may be served, in varying degrees, by the same actions. The precise balance among them is determined by the total goals of the country. Many possible combinations exist: a country may absorb an economic loss if there is a political, military, or political-military gain, or if there is no change, save for sufficient net gain in one of the other elements. The purpose of undertaking economic warfare is seldom singular; rather, it is usually a complex decision involving, to some extent, all of these factors.

B. Military Purposes

The military aspect of economic warfare has two basic dimensions. One involves the use of economic warfare as an adjunct to military operations; the other involves its use with respect to the peacetime military establishment and the preparation for war. In both, however, the aim is substantially the same. In peace, in preparation for war, or in war, a nation wishes to acquire the maximum net resources.

In peacetime or in preparing for military operations, the use of force may well be inappropriate, since it may jeopardize future plans. Economic warfare, however, may accomplish the same purposes. Resources may be acquired by improving the terms of trade of the country with respect to the rest of the world or with respect to a single nation or group of nations. A country may, through trade, acquire such influence in another country that the latter will be willing to form a military alliance with the former rather than forego the trade, or at least be willing to be neutral in a possible conflict. Furthermore, the victim may be induced to join in economic warfare actions against still other countries. Economic relations, too, may assume such importance and be subject to such manipulation that the trading partner will lose some or all of its sovereignty. Many techniques can and have been bent to these ends, such as the use of trade to disrupt markets, switching trade to and fro in an unpredictable manner, manipulation of foreign exchange and gold holdings, and many others. So long as these actions are undertaken to acquire resources and deprive a potential enemy of resources, then economic warfare is operating in direct support of military operations.

In wartime, economic warfare is a natural and important adjunct to military operations. Again, the principal purposes are to prevent resources from falling into the hands of the enemy and to acquire as many resources as possible. These and like techniques will be used, although a military blockade may be neither feasible nor desirable.

A special case of economic warfare is the embargo or partial embargo in anticipation of possible war. A country may apprehend a distinct possibility of war between itself and another country and then decide that no trade should take place which might enhance the war-making potential of the prospective enemy. If and when war does come, the enemy will not be as well off as it would have been if there had been no embargo. This type of economic warfare has frequently been employed preceding military operations. It is easily recognizable as an action which confers

short-run benefits on the perpetrator, but perhaps long-run benefits on the embargoed nation if the war does not come to pass. Most economies have such flexibility with modern technology that there is little for which a substitute cannot be found, even if at a somewhat higher cost. When confronted with an embargo, a nation immediately begins to develop substitutes, using the resources formerly exported to bear most of the costs of the development. If the embargo period is an extended one, the country will have made the necessary substitution, so that the complete embargo of wartime does not impose any further burden. It is even possible that this kind of economic warfare will backfire and that the potential enemy will be forced prematurely, at a time when perhaps it can better afford it, to prepare itself for war by developing self-sufficiency. In this case, the most that the initiator has done has been to impose on the enemy some added costs, but at the expense of facing not only a more adequately prepared enemy, but also one which is now insulated against this particular kind of economic warfare.

C. Economic Purposes

It is easily discernible that the military purposes of economic warfare, although directly in support of the military establishment, are basically economic in character. If a country is at war or proposes to go to war, then it must be said that economic warfare has a military goal; but if a country is not at war and does not necessarily intend to engage in warfare, then economic warfare may be serving an economic function. In both cases, the aim is the acquisition of additional resources and depriving another country of resources. All of the measures usable in wartime are also usable in peacetime. Some of them, however, such as preclusive buying, because of their intimate association with active hostilities, may not be used.

Generally, the actions constituting economic warfare for economic purposes fall into five categories: (1) guaranteeing sources of supply, (2) guaranteeing markets, (3) improving the terms of trade, (4) denial, and (5) economic takeover. The first three of these do not necessarily import economic warfare; they may be normal commercial transactions undertaken in pursuit of profit. They may, however, also be undertaken for the specific purpose of increasing the economic power of a country more rapidly than that of other countries. A wide variety of techniques is available for attaining these ends, ranging from those which are also usable in wartime to those apparently less predatory, such as gradually becoming a large trading partner and then threatening to withdraw trade, the building up of debts in other countries, the extension of credit, and many others.

Improvement in the terms of trade is accomplished by discrimination. The state trader, as a buyer, will offer different prices in different markets, the higher prices being offered where supply is relatively elastic. Purchases will be made to the point where the additional expenditures for additional units in different markets will be the same, not to the point where prices are equalized in all markets. It is the marginal expenditure in a given market, not the price, which guides the state trader. The state-trader, as a seller, operates in a similar fashion, selling in different

markets at different prices, the lower prices being asked in markets where the demand is elastic. The state trader sells to the point where the additional revenue in a given market is equal to the additional cost of the unit of exports sold in that market, not to the point where prices are equal in all markets.

D. Political Purposes

All of these acts of economic warfare may also be used to further the third important purpose of economic warfare—the pursuit of political advantage. This purpose, always important, has gradually assumed greater and greater importance as nations have become increasingly cautious about the use of force to achieve aims which transcend the economic benefits that may be conferred by economic warfare. The search for political power may take three forms. It may be quite general. A country may simply desire respectability and status. Many countries on the way up, in process of development or in the consolidation of revolutionary gains, may want, initially at least, only to be recognized and noted as a member of the family of nations. Other countries on the way back from a disastrous national experience may desire readmittance and a return to their former place.

The political purpose may also be manifested in a highly specific fashion. A country may wish to conclude an alliance or to obtain the vote of another in some international organization. Or it may want another country to eliminate a particular political or military leader, to undertake some change in domestic or foreign policy, or the like. The change sought may be either internal or external or both. In most cases, however, it concerns foreign policy, since it is in this field that the power position of the initiating country is most directly affected.

The ultimate degree of political as well as economic influence, however, is the takeover of another country. Just as economic warfare may be directed at reducing the flexibility of another country's economy to such an extent that the country can no longer make decisions with respect to its resources, so economic warfare may also be used to perform a political amalgamation, to deprive a country of its national sovereignty. In one sense, the takeover is the ultimate goal of all economic warfare, and the other objectives are but stepping stones to this end. This is true, however, only in a specific historic context, one in which a major world power feels itself endowed not only with the truth, but with the obligation to propagate it throughout the world. Throughout most of history, nations have been willing to set their sights much lower and have employed economic warfare to attain much more limited objectives.

E. The Other Country

Most of this article so far has been one-sided; it has taken the point of view of the nation which deliberately chooses to use economic warfare, and little has been said about the nations whose positions would deteriorate if this action were successful.

The victim may assume three basic postures. It may be passive and accept whatever solution the initiator of economic warfare proposes. This is a fairly rare

phenomenon. Much more common is the situation in which the victim fights back, attempts to defend itself, and grudgingly, if at all, gives in. The victim may choose to fight on the grounds already chosen—to break the embargo, or to extricate itself from the burdensome balances or whatever other snare or snares the initiator may be using. It may also fight back by using a different policy to attempt to inflict harm, so that the pressure will be relaxed. Thus, a country holding large balances of a country using them to elevate its own position may employ quotas or other restrictive or discriminatory policies to raise the siege. The third posture is one in which both countries are engaging in economic warfare against one another, but with different purposes in mind. In this situation, a country with a political purpose in mind may successfully be engaging in economic warfare against another country which is successfully engaging in economic warfare for economic purposes against the first country. The political gains of the former, if achieved, may more than offset its economic losses; and the economic gains of the latter, if achieved, may more than offset its political losses.

F. The Carrot and the Stick

In the conduct of economic warfare, there are only two basic approaches. They are the carrot and the stick, cajolery and coercion. Each has its applications. They may be used individually, but not infrequently they are used simultaneously. Which is used and to what extent depends upon many variable factors.

Historically, it is clear that the stick has been used most frequently. After obtaining a position of economic influence in one country, another may threaten to stop making purchases, to cut off supplies, to refuse to pay its obligations, unless some concession—economic, political, or military—is made. The two most common sticks are the use of the large-trader position and that of the debtor. Whether or not these devices will work depends a great deal upon the economic position of the victim and the market for its products. If the market is relatively brisk, a victim may chance switching to other markets rather than make a concession. And depending on the size of the debt, a victim in a favorable internal economic and trade position may be able to withstand nonpayment for some time on the expectation that it will eventually be repaid, regardless of whether or not it gives in. On the other hand, a slow market for its products, depressed world conditions, a very large debt, a large percentage of trade in the hands of another country may leave a victim with no alternative but to pay premium prices for its supplies, sell at a lower price to the other country, and let its political or military policies be influenced by its trading partner. The stick, when thus wielded, however, damages the general prestige and standing of the country using it.

The carrot, on the other hand, is a prestige builder. It consists in the use of foreign economic relations to favor another country and thereby win its good will and support. Favoritism is a delicate instrument and does not carry with it the sometimes unpleasant connotations of coercion; it may, however, be just as effective.

The usual method is to give more favorable terms of trade—either lower export prices or higher import prices—than would be provided in the world market, or to loan or give resources to the other country. On the basis of these economic favors, a country may expect in return reciprocal favors in the form of political support, an alliance, or perhaps neutrality. The recipient, however, may not be swayed by the economic benefits, in which case there is nothing the initiating country can do except return to the *status quo ante,* which still leaves the recipient in possession of some net gains.

One special aspect of the method of enticement may be labeled the drugged carrot. This method is most efficiently practiced by state-trading nations, since nations using private traders can seldom direct and shift trade readily. The recipient country becomes habituated to the favors of another and comes to regard these favors as fundamental to its welfare. So important do these economic considerations become that the recipient is deluded into thinking that concessions made to its benefactor are really in its own interest. The drugged carrot works best when there is at least an ostensible similarity of outlook and interest between the two countries. There is yet another aspect to the drugged carrot. While the recipient is being lulled by favors, the initiating country is gradually cornering a larger proportion of its trade, perhaps even a complete monopsony of some exports or monopoly of some imports. It is but a short step, then, from this vulnerable position to the use of the stick. In its stupor, the recipient may not recognize what is happening, and while it is still in this condition, the initiating country may withdraw, or threaten to withdraw the carrot.

A negative side to the use of the carrot must also be recognized. As a creditor nation, a country engaging in economic warfare makes itself vulnerable to the stick treatment from the recipient. If trade is large, this likewise makes the initiating country dependent on the recipient's markets and resources. This consideration, of course, makes little difference if one country is substantially economically more powerful than the other. The larger country can afford to pass up the debt repayment, can find other markets and new supplies. But the more comparable the countries are in economic power, or if special economic considerations render them proximate, the greater is the likelihood that this form of economic warfare may backfire and hurt the country which initiated it.

G. Techniques of Economic Warfare

All of those economic policies and acts which potentially can enhance the relative position of a country constitute the body of techniques of economic warfare. All of the particular acts may be classified as those which involve buying and selling and borrowing or lending.

The use of these techniques is consistent with either private or state trading. If private trading is the predominant form, however, then economic warfare can be waged only in so far as the government intervenes and acts, either positively or negatively,

to influence the decisions of private traders. A government-imposed quota or increased tariff in a country where private interests do the foreign buying may be an act of economic warfare if its intent is to improve the country's relative power position. A loan, a sale or purchase of some product, bilateral balancing of trade, or many other measures may also constitute economic warfare. The ingredient common to all of these techniques, is government action. Private actions may be in the national interest, although not necessarily so intended; only government action is intended to be in the national interest.

The choice of the technique in any given instance will be determined by the goals being pursued, problems in applying the technique, and the estimated effectiveness of the technique, taking into account the possibility of countermeasures and a change in the underlying economic conditions.

III

UNIQUE ROLE OF STATE TRADING IN ECONOMIC WARFARE

Perhaps the most singular characteristic of state trading is that the nation which practices it is necessarily and automatically engaging in economic warfare. Comprehensive state trading stands alone in its power as an instrument that utilizes economic means to improve a country's relative economic, political, and military position. All external economic transactions in the hands of the government implies that trade no longer is solely a means for increasing the income of the country by taking advantage of lower-cost products in other countries. Economic decisions are transmuted into economic-political-military decisions, in which costs are balanced against benefits in all aspects of national life before transactions are concluded. This is so because when the state controls external economic relations, it must take into account the total interests of the state, not just its economic interests. Only a conscious effort would permit the pursuit of economic interests alone, and it is highly unlikely, even then, that a state-trading country could, in fact, limit itself to purely economic objectives.

A state-trading nation has attained bargaining power far beyond that which a private-trading nation possesses in its trade. Earlier it was shown how the state trader, acting as discriminating monopolist and monopsonist, can reap economic rewards greater than private traders can. Even in cases where state trading is not comprehensive, the economic benefits are richer, a result of sheer size in the market. In economic warfare, this greater influence is very important, because it can be translated into political and military influence. The willingness to forego the potentially greater economic benefits which can be extracted by the state trader may result in substantial political concessions. Alternatively, the economic benefits may provide the state trader with such a position of strength that it can force a favorable political or military policy on other countries. Even if a private trader acquired economic power comparable to that of a state trader, he would be in no position to

translate this into other kinds of influence which might be beneficial to the state. He would be limited to economic objectives by the very nature of his role. State trading thus confers not only greater bargaining power, but also the ability to shift this power among the different goals of the state.

State trading is also a remarkably sensitive and flexible device for the conduct of economic warfare. All of the information and intelligence in the possession of the state can be made available to the state-trading organs immediately, and their conduct can be regulated in accordance with the interests of the state on a day-to-day basis. Government regulation of private trading, however, is much less attuned to immediate events and continual change. The measures, whether they be legislative or administrative, are more difficult to alter, once the course is set, and they frequently continue to implement their original objective beyond the time and under circumstances no longer beneficial to the state.

State trading is also relatively immune from interference by private economic interests. In a private-trading nation, even after government controls have set a course in the use of trade in economic warfare, there are always private interests seeking to undermine the government controls because their own interests are being harmed. Whether by circumvention or attempted circumvention of the controls or by agitation and pressure to alter the controls, interference can seriously weaken, render costly, or reduce the effectiveness of a measure. Once, however, a country has adopted state trading, the state is firmly in the saddle and can operate without fear of the nullification of its acts by domestic private interests.

Since economic warfare is not usually used alone, but rather in concert with diplomacy and with propaganda and psychological warfare, the relative ease and greater measure of coordination of state trading with the other policies of the government recommend it as a form of trading. Government controls over private trade are usually *ad hoc* and require new personnel and procedures. Accordingly, it is difficult to integrate private trading with diplomacy or with whatever propaganda and psychological means are being used.

It should not be thought, however, that state trading is a panacea and that economic warfare conducted by this method is necessarily the most desirable and most efficient. Aside from political and economic considerations which render any kind of economic warfare difficult, state trading possesses some disabilities not always shared by private trading, even under strict government controls. State-trading organizations are basically economic organizations, selling and buying and conducting business for the state. As economic units, their principal guide is price, economic gain, and economic loss. Despite the fact that the total interests of the state predominate, the state-trading organizations tend to think in economic terms, not in political or military terms. State-trading units and their political leadership must, therefore, be constantly alerted to the possibility that the state trader will act only for the economic benefit of the state and ignore broader aims. State trading, moreover, requires a bureaucracy and a relatively firm organizational structure. Thinking

becomes hardened, and sudden change, often required in economic warfare, tends to disrupt and delay operations. Vested interests in a given course of action can negate a potential gain. And policy conflicts in political leadership and between the political leadership and the trading apparatus, too, can nullify some of the benefits of state trading.

IV

State Trading and Economic Warfare in Action

A. Conditions Conducive to Economic Warfare

Economic warfare has been relatively circumspect because the advantages of such activities have not been decisive. It requires a peculiar configuration of power relationships, economic and political conditions, and forces at work in the world before it can be successful. For instance, where power is approximately balanced among several nations, with most of the rest of the world having little to say, a course of economic warfare by one may be self-damaging, since all the others can, and probably will, counteract. Where one nation clearly dominates the world, there is likewise little scope for economic warfare. In prosperous times, when a victim may turn to others in case of need with reasonably hopeful expectations, economic warfare may also turn sour. On the other hand, in an unbalanced turbulent world, full of political change and economic instability, when a country or countries are making rapid strides toward development, when powers are rising and declining, when world economic conditions are unfavorable, there are greater opportunities for successful economic warfare.

The contemporary setting probably holds more promise for state trading and economic warfare than any period thus far. Power relationships are delicately balanced, and a large number of nations are plagued by economic and political instability. Many nations have aspirations which can be attained by economic warfare. Two gigantic power groups stand opposed, nearly equal in military capabilities. A third group, recent to independent status, seeks to remain aloof from the conflict, but also seeks to use both sides for its own ends. Each of the opposing sides seeks to extend its sphere of influence by whatever means are available—in particular, using economic means to curry favor and extend its influence in the third group, perhaps even to the point of dominating some of the weaker countries in that group. One of the groups practices state trading, which automatically means that its trade will be used to promote the political, economic, and military interests of the group. That same group has developed an intensely materialistic, yet missionary, philosophy which not only charges it with converting (or subverting) the world, but which also has an appeal for the weak, poor, directionless, and unstable elements in the third group. Some nations in the third group, feeling themselves victimized by the other groups, and for independent reasons as well, have adopted state trading not only to protect themselves, but also to enhance their own power position. Under these circumstances, it is only natural for state trading and economic warfare to

wax strong. Indeed, the second half of the twentieth century, when its history is written, may well be known as the period of economic warfare.

B. The Contemporary Scene

The discussion so far has been abstract, dealing with general considerations. The reader no doubt has already illustrated with historical example many of the principles of state trading and economic warfare. Since space does not permit a full discussion of the examples, it may be desirable to confine examination to specific situations in recent years. It is proposed that the behavior of the Soviet Union in the postwar years be studied with reference to its state-trading activities and the role economic warfare has had in its foreign economic relations. This is appropriate, since the Soviet Union at the moment is the prime exponent of state trading in the world and in recent years at least has demonstrated considerable talent in using foreign trade to pursue its international aims.

In 1957, Nikita Khrushchev, Chairman of the Council of Ministers of the Soviet Union, said, "We declare war upon you [the United States] in the peaceful field of trade." This is as candid and clear a statement of intent to wage economic warfare that the world has yet heard. It signifies that the Soviet Union plans to use trade to improve its position relative to the United States. However, this is a peculiar kind of economic warfare, in that it is being fought away from the home ground of either participant. Rather it is being waged with the trading partners of both countries. The Soviet Union is using economic means to improve its relative political and military position. Indeed, the Soviet Union seems not to have tried to benefit economically, and in some cases has taken marginal losses. Soviet objectives have not been in the United States, but rather in Asia, Africa, the Middle East, and Latin America. Economic warfare is only one facet of the total Soviet effort, which includes elaborate diplomatic maneuverings, propaganda and psychological warfare on a large scale, and extensive cultural exchanges.

On the economic front, two principal devices are in evidence. The Soviet Union, along with its East European bloc and Communist China, has systematically set about to increase trade with underdeveloped countries. The unique characteristic of the trade is that it is all conducted through bilateral trade and payment agreements which envision a bilateral balance of trade and no use of foreign exchange. The second device is the establishment of lines of credit for raw materials, capital goods, arms, and technical assistance. Nearly every underdeveloped country has had Soviet and East European trade and credit offers, and many have accepted, resulting in a sharp percentage increase in this trade and credit extensions of about $2,400,000,000, of which about $700,000,000 ($400,000,000 in arms) has been utilized over the past four years.

Even so, relatively small amounts of resources have been involved, and the greatest Soviet efforts have been concentrated on just a few countries—Afghanistan, India, the United Arab Republic, and Yugoslavia. In order adequately to appreciate Soviet

economic warfare, it is necessary to examine some specific examples and from them deduce the pattern of Soviet behavior.

1. *Finland*

Finland, although defeated in World War II, was not occupied, but did participate in Soviet reconstruction through heavy reparations. The Soviet Union required Finland to build a metals industry which, after reparations were paid, was not competitive. In order to avoid large losses and unemployment, Finland has maintained the industry by shipping three-fourths of its metals products to the Soviet Union, which also has purchased large quantities of other Finnish exports. Through triangular arrangements, the Soviet Union has encouraged Finnish trade with East Europe. The Soviet Union provides twenty per cent of Finnish imports and buys about the same amount of Finnish exports (about thirty per cent if East Europe is included). But even this strong position is enhanced by a Finnish export balance which the Finns have vainly tried to collect and by the fact that the Soviet Union and East Europe provide nearly all of the grain, oil, coal, and fertilizer requirements of the Finnish economy.

Soviet purposes in Finland are clear. At first, the Soviet Union wanted, and got, economic succor. More recently, the Soviet Union has wanted Finland in a position similar to the rest of East Europe—not necessarily Communist, but lacking enough freedom of action to steer a completely independent course. Finland has a military alliance with the Soviet Union, and its military establishment is deployed for use against Norway. Finland is required to support Soviet foreign policy in some respects, and any effort to discriminate against Finnish Communists is resented by the Soviet Union. So far, it has only been necessary to hint that Soviet import purchases will decline to force the Finnish Government into the desired action. In December 1958, the Finnish Government fell as a result of Soviet economic pressure which was applied when the Communists, the largest party in Finland, were left out of the new Government. Thus, Finland is an example of economic warfare in which trade has been used successfully to attain political and military ends.

2. *Yugoslavia*

At the other end of East Europe, Yugoslavia has been subjected to unremitting economic warfare. Its most interesting characteristic has been the wide variety of techniques used. The Soviet Union started out shortly after the war by assisting Yugoslavia, enlarging trade and providing some economic assistance. Tito, however, would not accept all aspects of Soviet policy. In order to force this acceptance, the Soviet Union, in 1948, cut off trade, as did East Europe. Yugoslavia, however, was able to turn to the United States, Great Britain, and West Germany and did not yield to the Soviet Union. Continued pressure did not accomplish Soviet goals. After Stalin died, the new Soviet leadership adopted other tactics, and the period between 1953, and 1958 was marked by intermittent improvement and deterioration in Soviet-Yugoslav relations. In general, however, there was improvement. The Soviet Union

and East Europe expanded their trade with Yugoslavia and committed themselves to loans of nearly $500,000,000. Still, Tito refused to bow to Soviet ideological guidance. In May 1958, the crisis recurred. The Soviet Union, which had once before temporarily delayed loans, postponed two important loans, and trade began to dwindle. The West has once again come to the aid of Yugoslavia.

Thus, the Soviet Union started with the carrot, took to the stick in 1948, began using the carrot again in 1953, but with occasional lapses when the stick was brought out, and finally, in 1958 decided to use the full stick again. It is evident that Yugoslavia is incorrigible, and so long as some minimal assistance from the West is a realistic alternative, that country will continue to resist. The Yugoslav case illustrates that economic warfare does not necessarily imply success and requires for its effective operation the absence of a practical alternative which may be accepted without prejudicing the position of the victim.

3. *Iceland*

The Soviet Union and East Europe have accounted for from zero to one-third of Iceland's exports over the past five years. Trade volume has followed the fortunes of the local Communist movement and Communist participation in the Icelandic Government, as well as Iceland's squabbles with other Western countries, notably Great Britain. The Soviet Union has been most interested in trade when a Communist was in the Government, which happily coincided with a dispute with Great Britain resulting in a sharp decline in British imports from Iceland.

Iceland, plagued by serious inflation and facing economic crisis, and in continual dispute over fishing rights with West European countries, may have been nibbling on a drugged carrot. With one-third of its exports pledged to the Soviet Union and East Europe, Iceland is easily a candidate for the stick treatment. The Soviet Union has important interests in that country: a NATO air base and a large Communist Party. It is possible that Iceland will feel pressure for the elimination of the airbase and withdrawal from NATO in order not to displease its largest trading partner. With one-fifth of the vote going Communist, the Icelandic Government has felt itself compelled to include a Communist in its cabinet in recent years. Thus, the Soviet Union has used its trading position, made possible by state trading (private-trading countries continue to impose restrictions on Icelandic fish to protect domestic interests), to work itself into a position where important military and political objectives may be achieved.

4. *United Arab Republic*

Soviet economic warfare against the United Arab Republic is a drugged-carrot operation, using both trade and economic assistance. Starting with an arms loan in 1955, Soviet and East European activities have required, for payment, an increasing share of Egypt's cotton exports, to the point where the Alexandria market sells nowhere else and Egypt's Western markets have dwindled away. A Syrian arms deal followed. In 1957, economic warfare, combined with diplomatic pressure, internal

subversive activities, and propaganda, was leveled at Syria, with the apparent intent of a takeover in that country. This is one of the few times a nonviolent takeover had been attempted, and it failed. Rather than fall to the Soviet Union, Syria chose to join Egypt in the United Arab Republic.

The economic warfare continues. The arms debt is probably $400,000,000; Egypt is supposed to get $175,000,000 for economic development and $100,000,000 for the Aswan High Dam. Syria is getting $160,000,000 for economic development. To pay for the arms and as payments on the loans come due, trade must be redirected and Soviet influence will grow. Nasser has shown considerable independence so far. When thoroughly hooked, he is vulnerable to the stick, however. It should not necessarily be assumed, however, that Nasser has been completely lulled. In general, the Soviet Union has been following and espousing his policies in the Middle East—not the other way around. When the Soviet Union is deeply committed, Nasser may find difficulty, in fact or in fancy, in repaying loans unless the Soviet Union continues to support him politically. But in any event, both the United Arab Republic and the Soviet Union seem to be gaining, while the West is losing.

5. *Burma*

In Burma, Soviet economic warfare has so far been a failure. In 1954, the Soviet Union's state-trading organ, with complete indifference as to Soviet rice needs, began purchasing Burmese rice because that country had large stocks and was facing a crisis. Between 1954 and 1957, the Soviet Union, in concert with East Europe and Communist China, took, in barter deals, about fifteen per cent of Burma's exports. Two factors, however, deprived the Soviet Union of substantial political gains, perhaps even the drawing of Burma within its orbit. First, Soviet commercial policy was so inept that the Burmese Government was alienated through slow deliveries, high prices of Soviet goods, and many other irritants. Second, the rice market picked up in 1955, enabling Burma to sell rice for cash. Thus, Soviet political goals have been frustrated.

6. *Other Countries*

Since 1953, nearly every underdeveloped country has been approached by the Soviet Union, with a proposition to expand trade or with a credit offer. Naturally, it has been the neutralist group which has received the greatest attention. But even Western-oriented countries, such as Pakistan, Turkey, Iran, Argentina, Brazil, and Uruguay, have expanded their economic contacts with the Soviet Union. Much of what has gone on could easily pass for normal commercial relations, but for the basic nature of trade in the Soviet Union. State-trading organizations have all too clearly attempted to keep political factors in mind in concluding transactions.

C. Evaluation of Soviet Economic Warfare

The fundamental world conditions must be kept in mind in attempting an evaluation of Soviet state trading and economic warfare. The basic political facts are that

the old balance-of-power situation is gone and world power is precariously shared by three groups: the United States and its allies and friends; the Soviet Union and its sphere of influence; and a third group of new countries having varying degrees of allegiance to one or the other of the other groups and to a new kind of neutrality in which countries seek to advance their self-interest by noninvolvement with either group, but by exploitation of the rivalry between them to obtain political and economic succor from both. Intense political and economic nationalism characterizes the posture of the third group, which, recently freed from colonial status, seeks economic development and great increases in the standard of living by the most rapid route possible. Further, this third group is principally dependent on the export of primary products which are subject to wide price and quantity variations, a situation not compatible with smooth and steady economic progress. Soviet economic progress in the last forty years has been substantial, and many countries in the third group, in surveying the relative rates of growth of the world powers, seem to perceive in the Soviet example the model for their own growth, ignoring comparable growth of other powers when in the same stage of development as the Soviet Union.

Thus, world conditions have tended to promote the political and economic fortunes of the Soviet Union; and by cleverly fostering the idea that it is competing with the West, the Soviet Union has been able to dramatize this tendency. By remaining alert and sensitive to the economic problems of underdeveloped countries and by selectively using its political influence in causes popular among the third group of nations, the Soviet Union can make the basic structure of world conditions operate in its favor.

1. *The carrot with the stick held behind*

Appropriate to these world conditions and its own position in the world, the Soviet Union has chosen as its basic approach the carrot. This carrot has, in general, taken the form of mutually advantageous trade and the extension of credit. In themselves, these are powerful weapons, but the Soviet Union has tried to intensify their effect by orienting them to the special needs of primary-producing countries. In chronic need of foreign exchange, primary producers are offered trade through a device which obviates the need for foreign exchange—the bilateral trade agreement with bilateral balancing. Despite the fact that this technique is economically unsound—it distorts the most advantageous distribution of production and exchange of goods—it is highly welcomed because it assists in solving a difficult short-run problem. Sensitive to the economic development aspirations of underdeveloped countries, the Soviet Union offers capital goods in exchange for primary products—that is, it emphasizes the complementarity which is emerging between the Soviet Union and underdeveloped countries.

Soviet goals, however, are such that the carrot is not always the most efficient method. Thus, there have been instances where coercion has been attempted or used. This has been possible only in those situations and places where favorable economic

relations had been built up, usually over a period of several years. It appears that the Soviet Union desires to be in a position where either the carrot or the stick can be used, depending upon its immediate goals and the situation. The carrot, therefore, has a strong narcotic in it. It is designed to maneuver the trading partner into heavy dependence on the Soviet Union for either a substantial proportion of its total supplies and its market, or particular supplies and market. The credit program increases this trade effect, makes the recipient dependent on the Soviet Union for parts and replacements, and leaves the recipient in a position where it must face the costs of unfinished projects should the Soviet Union withdraw its aid. The Soviet Union has even attempted, in part, to reap some of the benefits of a debtor position, such as that which worked so well for Germany before World War II. This is possible only in special circumstances, but it can succeed even when a recipient country occupies a debtor position on capital account. Delayed deliveries by the Soviet Union and prompt deliveries by the primary producer, a not uncommon circumstance, leave the Soviet Union in a debtor position on current account and can be used to subject the bilateral clearing account to economic pressure by the Soviet Union.

2. *Motives and goals*

The Soviet Union seeks political and military objectives in its economic warfare. They have two major foci. First, the Soviet Union seeks recognition as a world power, to be considered in all decisions in all parts of the world. Having labored so long under a cloud on the very fringes of the family of nations, the Soviet Union wishes to make up for lost time, now that its economic, political, and military capabilities are matters to be reckoned with on a global scale.

But the Soviet Union seeks not only recognition of its status. The particularized nature of Soviet economic warfare indicates highly specific objectives, nearly all of a political or military character. The Soviet Union wishes to break up the system of military alliances built up by the United States following World War II. Further, the Soviet Union wants to see potentially hostile military bases of the United States in foreign countries dismantled. Iceland is a case in point, as are Tunisia and Morocco, where the Soviet Union has incipient economic relations.

Political goals, however, are probably the most important. These range from diplomatic recognition by countries in Latin America, to the reinforcement of neutrality in India and Burma, and the encouragement of neutrality in Iran and Indonesia. Neutrality is, of course, not the end goal of the Soviet endeavors, but from the Soviet point of view, neutrality is to be preferred over a pronounced Western orientation. The Syrian experience indicates that the Soviet Union is prepared to go beyond the influence stage and, under propitious circumstances, will endeavor to control another state. The Soviet Union, appreciating fully that it is living in a tripolar world, seems content, for the time being, to assist the third group on its way up, especially

since this is being done at some political cost to the West and a slight political benefit to the Soviet Union.

Economic motivation probably plays a quite subordinate role in Soviet economic warfare. The Soviet Union has not consciously sought economic gain beyond that which would derive from normal commercial activities in most cases. In the instances where there has been a substantial economic benefit to the Soviet Union involved, it is likely that it was unintended, a result of inexperience and overzealousness on the part of a Soviet trade organ. In another sense, however, economic considerations have been vitally important. It was only after thirty years of industrialization, unusually high investment, and deprivation of consumers that the Soviet Union was able to develop sufficient complementarity to consider undertaking the kind of economic warfare on which it is now embarked. Only during the past few years has the Soviet Union been able to consider mutually advantageous exchange of goods with primary producers. This provides them less with motivation, at least at this time, than with the capability.

Conclusions

State trading and economic warfare, once regarded as abnormal and deplorable departures from the classical world of comparative advantage, must now be accepted as permanent and irremovable fixtures in the world economic scene. They are also intimately related to one another, as a technique is related to an endeavor. State trading is unique in its relation to economic warfare, in that it is the only commercial policy by which the economic, political, and military interests of the state are automatically and simultaneously considered in making decisions about commercial transactions. It also possesses the advantage of providing a country with greater bargaining power, greater sensitivity to the state of affairs, and greater flexibility in meeting particular situations; and it brooks no interference by domestic interests.

Economic warfare, the self-conscious attempt to use foreign economic relations to elevate the interests of the state, is best exemplified by its goals, which are economic, political, and military benefits to the state, and by the approaches used by countries conducting economic warfare, which are the carrot-method of enticement and the stick-method of pressure and coercion. The acts of economic warfare are conditioned by world conditions, by the power alignments in the world, and by the role of the initiator of economic warfare in world affairs. Economic warfare has been successful historically, principally in coercing other nations to grant concessions, but success is not guaranteed. The stick cannot be counted upon if the victim has an alternative, and the carrot, most useful in general influence-building, is of little use in extracting concrete advantage. Frequently, the success or failure of economic warfare depends less upon the economic warfare itself and more upon accompanying diplomatic, cultural, propaganda, and psychological activity. Most important of all, the climate of world opinion and basic forces at work in any given period dictate the effectiveness of economic warfare.

To the prevailing winds of nationalism, anticolonialism, desire for economic development, propensity for planning, and sense of urgency felt since the end of World War II among underdeveloped countries must be attributed some of the success of Soviet economic warfare in recent years. Soviet economic warfare itself has not displayed any great talent so far in getting things done, owing to inexperience, lack of resources, and an ideology which is not always helpful. The future will probably see an enlarged and better-conducted Soviet economic warfare, but not necessarily a more effective one, since in a tripolar world, success depends not only upon the Soviet Union, but also upon the West and upon the underdeveloped countries themselves, whose overriding concern is the avoidance of outside domination.

Whether it fails or succeeds in any given instance, economic warfare will persist. It will be employed by any power which has an expectation that it may thereby benefit. In particular, it is possible that the developing countries of Asia, Africa, and Latin America will use economic warfare, as the use of force, even on a local scale, increasingly falls into disrepute and desuetude. The major powers, to whom force is almost barred by its devastating and self-defeating consequences, will also increasingly turn to economic warfare, as well as other nonviolent means, to achieve their ends.

THE ECONOMIC CONSEQUENCES OF STATE TRADING*

Don D. Humphrey†

Introduction

By itself, the existence of state trading tells us little or nothing as to the economic consequences. If exports are sold above the domestic market price, the effect is exactly the same as a tax on exports under a regime of private trade. Similarly, if the offer price for imports is below the domestic market price, the effect is exactly the same as a tariff on imports equal to the difference between domestic and foreign prices. Throughout the present article, the analysis abstracts from transport costs.

As compared with free markets, we would normally expect a state-trading organization to attempt to reduce the cost of imports and to raise the price of its exports. But it may, conversely, buy imports above the world market price and, as in the case of American farm surpluses, sell exports below the world price. Subsidies to private trade would have similar effects. The economic consequences are determined by the price-spread that is created between domestic and foreign markets and by the state-trading price, which need not match the market price of either country.

Thus, state trading has essentially the same economic consequences as taxes and subsidies, although it may involve more blatant use of monopoly power. For one thing, it is doubtless easier to conceal precisely what happens under state trading than under the traditional forms of state intervention with free markets. For another, state trading may be used to pursue political objectives at the expense of economic gains. For example, it may be used for preclusive buying as an instrument of economic warfare, or as a means of providing foreign economic assistance.

Perhaps it might also be argued that state trading is likely to depart more radically from the free-trade position than the traditional controls of foreign trade. But this argument rests more on administrative and political considerations than on economic analysis. While it is true that governments find state trading an extremely flexible instrument for discriminating between separate markets, we should guard against mistaking this for a radical innovation, simply because the economic analysis is complex. Apart from flexibility, it seems doubtful if a country's bargaining power is increased by state trading, as compared with other forms of control. But a country willing to resort to the brutal use of economic power will find state trading a suitable instrument.

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I

STATE TRADING COMPARED WITH FREE MARKETS

A. The Dilemma

Uniform prices between spatially separate markets are desirable on the ground of efficiency and economic welfare. If the price of a commodity is unequal between two countries, the economic welfare of both can be increased by trading until the difference in price is eliminated. In the absence of monopoly power, private traders tend to produce this result by seeking to maximize profits. They buy in the low-priced market and sell in the high-priced market until prices are equal.

State-trading monopolies create a dilemma because, if they follow the rule of private trade and seek to maximize profits, the economic welfare of the world is impaired by misallocation of resources. Resources are misused in this case because of undertrading as compared with the competitive volume of private trade. It will pay a state-trading organization to discriminate by buying or selling at different prices in separate markets. This is simply because state-trading organizations have enough monopoly power to influence the price by their own actions.

The objection to price discrimination from a welfare standpoint is that, typically, the exporting country's low-cost production is restricted by raising the price of its exports, while the importing country's high-cost production is stimulated by the higher cost of imports. As a result, the pattern of consumption is distorted in both countries. These effects are the result of undertrading which yields monopoly profits. Hence, the dilemma that a state-trading monopoly must forego monopoly gains in order to avoid the undesirable effects of undertrading from a cosmopolitan viewpoint.[1]

B. The Effects of Undertrading

The following analysis compares the effects of state trading with free trade under competitive conditions, since the latter is a familiar point of reference. In order to simplify the exposition, it is assumed in each case that the elasticity of demand with respect to price is greater than zero and that supply is less than infinitely elastic.

Suppose that a state-trading monopoly attempts to reduce the cost of imports. If it offers less than the domestic price for imports:

(1) foreign consumption is stimulated,
(2) foreign production is restricted,
(3) domestic consumption is restricted, and
(4) domestic production is stimulated.

[1] Price discrimination is not confined to state trading, although in this case, the problem is more acute. It is not uncommon for private firms to sell exports either above or below the domestic price. In some instances, the problem is to allocate overhead costs between products which are largely exported and others which are sold chiefly in the domestic market. With a change in the composition of ouptut and conventional allocation of overhead, discrimination may be unintentional. The demand of large firms for imports may also be important enough to influence the price.

These economic consequences are exactly the same as the effect of a tariff on imports. The consumption and production losses from inefficient use of resources are indicated more precisely by graphic analysis at the close of the present article.

Conversely, if the government sells exports above the domestic price:

(5) foreign consumption is restricted,
(6) foreign production is stimulated,
(7) domestic consumption is stimulated, and
(8) domestic production is restricted.

The eight effects outlined above are exactly the same as the economic consequences of a tax on imports and exports equal to the spread between domestic and foreign prices. State trading will show a profit if imports are bought below domestic price or exports are sold above domestic price. That profit is equivalent to the revenue from a tax and will have the same restrictive effect on trade.

The explanation of items (3) and (4) and items (5) and (6), respectively, is that domestic price is increased by state profits on import trade and foreign price is increased by state profits on export trade. But the explanation of items (1) and (2) and items (7) and (8) may not be equally apparent to the reader who is unaccustomed to dealing with the terms of trade. The explanation of items (1) and (2) is that the profits (tax) on state trading restrict imports and, thus, decrease the foreign price by leaving a larger supply in foreign hands. Similarly, for items (7) and (8), the profits (tax) on state trading restrict exports and lower the domestic price by leaving a larger supply in domestic hands. Just how much of the state-trading profits the foreigner can be made to pay depends on the terms of trade effect, which is discussed below under "Bargaining Power."

A country seeking the maximum advantage from state trading will discriminate also between export markets and between sources of imports. Compared with competitive bidding, it pays to offer lower prices to those countries whose export supply is inelastic and higher prices to those countries whose supply is elastic. Since a lower price in inelastic markets reduces the quantity offered only slightly, while a higher price in elastic markets increases the supply substantially, the average cost of imports is reduced by price discrimination.

Similarly, on the export side, since higher prices restrict sales very little in inelastic markets, while lower prices expand the price-sensitive market substantially, it pays to discriminate according to the elasticity of foreign import demand and charge higher prices, the more inelastic the demand.

C. Bargaining Power

In brief, the home country has a strong bargaining position if domestic production is a good substitute for foreign production in the home country's consumption, but a poor substitute in the foreign country's consumption, and conversely. In addition, a country's trading position is stronger (weaker), the smaller (larger)

the additional cost of expanding its import-competing industries by shifting resources which contract its export-producing industries.

Considerable insight into the nature of this problem may be gained by reference to the terms of trade effects under competitive trading. Other things being equal, a country's bargaining power with respect to imports will be greater, the larger and more elastic its home consumption and production, and conversely. For if the cost of imports is raised against it, the contraction of its import demand will be greater, the more easily consumption can be shifted to substitute products and the more readily home production expands.

For similar reasons, the importing country's bargaining power is greater, the smaller and less elastic the foreign export supply, and conversely. For if foreign production cannot be shifted readily to other lines and foreign consumption is not responsive to a small reduction in price, the foreign country is constrained to export at less favorable terms than under the opposite conditions.

The exporting country's bargaining power is also greater, the larger and more elastic its home consumption and production. For the more readily the contraction of exports can be absorbed by consuming more and producing less at home, the greater is the country's ability to face a period of no trade, and conversely. In addition, the exporting country's bargaining power is greater, (1) the smaller its exports relative to home production, and (2) the larger its exports relative to foreign production.

It is interesting that these rules, which govern the terms of trade effects under competitive conditions, seem to be indicative, also, of the bargaining strength of state-trading monopolies.[2]

Now, the ultimate economic sanction is to stop trade entirely for a period rather than accept less favorable terms. As the stronger country succeeds in gaining favorable terms, its power to extract still more concessions diminishes, because complete stoppage of trade would then involve a more serious loss to the stronger country and a less serious loss to the weaker country.

In considering the trading position of *two* countries, the elasticity of the rest of the world's export supply may be counted as part of the importing country's bargaining strength. Similarly, the elasticity of third countries' import demand will augment the exporting country's bargaining power.

1. *An illustration*

Price discrimination and bargaining power may be illustrated by foreign trade in rubber. Since the United States now produces chemical rubber, its import demand for natural rubber is presumably more elastic than that of other manufacturing countries which produce no close substitute. Hence, if the natural-rubber-producing countries were to form a state-trading cartel, their profits could be increased by

[2] See GOTTFRIED HABERLER, THE THEORY OF INTERNATIONAL TRADE 227-30 (1950); *cf.* J. E. MEADE, TRADE AND WELFARE 183-85 (1955). The present article is substantially indebted to Meade, especially the latter part of *id.* c. 10.

charging higher prices to other countries than to the United States. Moreover, the elasticity of foreign import demand for raw rubber is likely to be low. Assuming that automobile tires are the principal use of rubber, it seems unlikely, for example, that automobile sales would be appreciably restricted by a ten per cent increase in the price of raw rubber. The producing countries would have to act in concert; otherwise, the importing countries would shift their purchases to the cheapest source of supply.

Since demand for one good is a function of the price of its substitute, American consumption of chemical rubber could be reduced by lowering the price of natural rubber in the United States. The state-trading monopoly could increase profits, at least in the short run, by charging higher prices to those manufacturing countries whose import demand for natural rubber is less elastic than that of the United States. Price discrimination can be profitable so long as there are differences in the total elasticity of demand.

But in the long run, the higher price of natural rubber in other manufacturing countries would stimulate their demand for chemical rubber. They would be encouraged, by price discrimination, to import chemical rubber from the United States and to produce chemical rubber at home. In the end, the world would make too little use of its natural resources for producing natural rubber and use too much scarce capital to produce man-made rubber.

From this, it will be clear that the bargaining strength of natural-rubber-producing countries has been reduced by the advent of chemical rubber, which increases the elasticity of demand for natural rubber. Moreover, the bargaining position of natural-rubber-producing countries may be weak because (1) elasticity of home-country demand for rubber may be zero, and (2) the supply of natural rubber is likely to be rather inelastic until producing countries are sufficiently developed to have alternative employment for their resources.

D. Subsidized State Trading

Thus far, we have considered state trading mainly as a means of raising the price of home-country exports and lowering the price of home-country imports. This involves undertrading as compared with the free-market volume of trade. In the opposite case, a state monopoly might overtrade, which would have the same economic effects as a subsidy to private traders.

Now, a state monopoly which paid a premium price above the free market for its imports and sold its exports below the free-market price would have economic consequences exactly opposite to the eight effects outlined above, provided always that the volume exceeded the free-market volume of trade. Thus, if a state monopoly were to expand the volume of its import trade by means of a subsidy:

(1) foreign consumption would be restricted,

(2) foreign production would be stimulated,

(3) domestic consumption would be stimulated, and
(4) domestic production would be restricted.

This would result in misallocation of resources and distortion in the pattern of consumption which would decrease the economic welfare of the world. The effects of overtrading are symmetrical with the effects of undertrading.

It may be of interest to consider also some hybrid cases—namely, those where a subsidy does not lead to overtrading. Governments may, for noncommercial reasons, decide to subsidize trade. But this decision does not necessarily entail an expansion in the market volume of trade. In fact, a subsidy may be combined with undertrading.

One of the strident complaints heard from many parts of the world today is that the terms of trade are unfair to raw-material-producing countries. We are not concerned here with the justice of this complaint, but rather with the economic consequences of measures to assuage the new nationalism of underdeveloped countries. Except for the disposal of our farm surpluses, the United States is prone to insist on private trade at market prices, while, at the same time, we give economic assistance to underdeveloped countries. On the other hand, the Soviet Union and Communist China, as it suits their political strategy, are ready to buy raw materials at a premium above the world market price. What is the difference?[3]

Let us imagine, first, that the American Government were to subsidize state trading for the purpose of assisting the economic development of raw-material-producing countries and to forestall economic penetration by the Soviet Union. Assume that the Government pays a premium price of ten per cent and imports at a loss whatever quantity is demanded by domestic buyers at the free-market price. In this case, state trading has no direct effect on foreign trade or on the use of national resources, because both the foreign and domestic market price remain unchanged. Exactly the same effect could be achieved by a foreign export tax combined with an American import subsidy to private traders. Either state trading or tax-cum-subsidy would provide foreign economic assistance, financed largely by the American income tax. Since state trading may help to avoid the stigma of inferiority often felt by the poor, the exporting country might prefer a premium price for its exports to direct financial assistance. This feeling is not so surprising when we recall that American farmers strongly prefer "fair prices," which enable them to "earn" their income by "getting it through the market," to direct subsidies by the Treasury.[4]

Secondly, suppose that, after a time, the Congress refuses to continue the subsidy, but sanctions continuation of premium prices for imports. The state-trading monopoly then pays a ten per cent premium above the foreign price, but neither loses nor

[3] Whether or not the Soviet Union provides foreign economic assistance by paying a premium price for imports depends, obviously, on the price charged for Soviet exports.

[4] A more practical reason for this preference may be the difficulty of getting the Congress to vote taxes for direct subsidies, even though government support prices are equivalent to a tax on consumption.

profits from raw material imports, which it resells at cost in whatever quantity the domestic market will absorb.

In this case, the effect on use of resources is exactly the same as an import tariff of ten per cent, the revenue from which is turned over to the exporting country. Such a policy would provide foreign economic aid by taxing imports. The same effect could be achieved by a foreign tax on exports (provided that America co-operated by placing a prohibitive tax on raw material imports via third countries). Thus, the difference between unsubsidized and subsidized state import trade at premium prices is that the first taxes American consumption of imports, while the second provides foreign aid, mainly, by taxing American incomes. The import tax reduces the economic welfare of the world by distorting the pattern of both consumption and production, while the income tax affects only the incentive as between work and leisure.

State-trading restrictions on raw material imports also have important indirect effects on the foreign trade between manufacturing countries. These will presently be treated by graphic analysis.

1. *America's farm surplus*

From the above, it is clear that the effect of subsidized state trading depends on whether there is undertrading or overtrading as compared with the competitive volume of trade. A simple case of overtrading because exports are priced below the world market would:

(1) stimulate foreign consumption,
(2) restrict foreign production,
(3) restrict domestic consumption, and
(4) stimulate domestic production.

But the state trading of American farm surpluses is by no means this simple. In the first place, American commercial exports are restricted by high domestic support prices coupled with acreage controls. Although farm production is not rigidly controlled, acreage allotments have been reduced as output per acre increased. Thus, both domestic and foreign consumption are initially restricted, and, in some cases, production is doubtless stimulated in third countries.

In the second place, most foreign countries protect domestic agriculture by restrictions on imports and, in some instances, by subsidies to production and exports. For these reasons, commercial exports are undertraded, compared with the free-market volume, so that some subsidy is required to expand trade to the free-market level. This, however, is not the primary objective of the Commodity Credit Corporation.[5] Although our domestic farm program carries an umbrella which, to some extent, protects the home production and exports of third countries, our policy is to

[5] Even though the mechanics of exporting farm surpluses may be delegated to private traders, they act as agents of the Commodity Credit Corporation, which owns the commodities and determines the terms on which they are sold.

make every effort to dispose of America's domestic surpluses in markets and on terms which do not interfere significantly with commercial exports.[6] This provides an excellent example of the administrative flexibility of state trading. It appears impractical to attempt the same thing by means of subsidies to private trade.

E. Exchange Rates

Like other departures from the free market, the effect of state trading on the use of resources cannot be evaluated without reference to the equilibrium rate of exchange for currency, which balances a country's exports and imports.

Suppose that a state-trading monopoly imports freely whatever is demanded by domestic buyers at a price ten per cent above the foreign market price, which is equivalent to a ten per cent tariff across the board. If the country's currency were initially overvalued ten per cent with fixed exchange rates, this restriction on imports would represent a step toward the equilibrium free-trade position. For if the currency were devalued to the equilibrium price, private traders would have to pay ten per cent more of their own currency to obtain the foreign exchange for each deal; this is the same as a state-trading monopoly which charges domestic buyers ten per cent above the foreign price before devaluation. In order fully to restore the equilibrium terms of trade without depreciating its overvalued currency, the state monopoly would also have to subsidize exports across the board and sell them ten per cent below domestic costs. In this sense, a debtor country whose exchange rate needs adjustment may be moving toward a free-trade position by a state-trading monopoly which subsidizes its exports and profits from its import trade.

What, in the opposite case, is the effect of a state-trading monopoly which charges a uniform ten per cent excess price above the domestic market for all its exports and undertakes to satisfy all demands for imports at a price ten per cent below the domestic market? This would have exactly the same effect as a ten per cent appreci-

[6] To disentangle the effect of state trading on the use of resources from broader aspects of the domestic farm program would require detailed examination, commodity by commodity, and only a few general suggestions can be offered here. In selected markets, state trading has undoubtedly increased foreign consumption. Without this discriminating export trade, domestic price supports would probably break down sooner, owing to the cost of accumulating huge domestic surpluses.

A basic question is the extent to which domestic support prices retard the shift of farm labor to more productive nonfarm employment. The answer varies so substantially between geographical areas that generalization may easily be misleading. Despite support prices, the rate of migration off farms has been impressive. Inconclusive statistical evidence suggests that migration depends more on the nonfarm demand for labor than on the level of farm prices. This implies that the return to human resources on the farm is still below the return to comparable resources in nonfarm employment.

A corollary of the domestic farm program has been a great improvement in methods of farming, so that human and capital resources are used more efficiently. But some land is farmed overintensively and is probably overvalued as a result of excessive land rents produced by acreage controls.

Finally, the criteria of economic efficiency are perfectly competitive equilibrium prices. But owing to the inelasticities of demand and supply, the free-market price is likely to diverge substantially from the long-term equilibrium. For this reason, current free-market agricultural prices may not be a very good criterion of economic efficiency in areas where the farm labor supply is excessive and off-farm migration continues at impressive rates.

ation of the country's currency.[7] If we assume that trade were initially balanced and, further, that free exchange rates were allowed to preserve equilibrium trade, state trading, as prescribed above, would have no real effect whatever, because the country's currency would depreciate by ten per cent, thus offsetting exactly the effect of a uniform subsidy and export tax.[8]

Now, it is obvious that the essence of state trading is discrimination, rather than the uniform treatment of exports and imports. The purpose of this theoretical excursion is merely to show that with rigid exchange rates and disequilibrium trade which have commonly prevailed since the war, it is impossible to evaluate precisely the effects of *ad hoc* state trading. But enough has been said to indicate why state trading, as well as other restrictions and subventions, may represent a step toward, as well as a departure from, the optimum trading position from the point of view of world consumption and production.

F. A Second Best

The world is full of man-made constraints on production, consumption, and trade. We seem prone to assume that if all the optimum conditions are unattainable, the second-best choice is to attain as many as possible. This common-sense view is in error. There is no *a priori* basis for evaluating suboptimal alternatives. If the best is unattainable, it is not necessarily, or even probably, true that a second-best choice is one which fulfills more, rather than fewer, optimum conditions.[9]

When a constraint is introduced which removes one of the optimum conditions of trade, the remaining conditions for achieving the optimum are, in general, no longer desirable, even though attainable. For a second-best optimum is achieved only by introducing appropriate countervailing constraints. Moreover, a second-best solution can be achieved in many different ways, for while there is only one first best, there are many second bests.

The implication of this general theorem is, it seems, to moderate any general criticism which might be aimed at state trading, as such. The policy implied by the theory of a second best is that one market imperfection justifies another, provided the second goes as far as possible to offset the first. But this should not be construed to imply that state traders actually seek a second best, or, in fact, really know what they are doing in terms of evaluating suboptimal opportunities for trade.

[7] Strictly speaking, the tax and subsidy in each case would have to apply to all transactions, including invisibles as well as commodity trade.

[8] It may be of interest to note that profitable state import trade may have the same economic effect as profitable state export trade accompanied by adjustment of the exchange rate. If the currency is devalued 10% and a state monopoly charges a uniform profit of 10% on all exports, the effect is exactly the same as charging a uniform profit of 10% on all imports with fixed exchange rates. Devaluation, in the first case, offsets the effect of state trading on the export terms of trade and, at the same time, raises the cost of imports by 10%. This is exactly the same as the second case, in which state trading raises the cost of imports by 10%. Meade makes this point, though not in connection with state trading. MEADE, *op. cit. supra* note 2, at 166.

[9] See Lipsey & Landcaster, *The General Theory of the Second Best*, 24 REV. ECON. STUDIES 1 (1956).

G. General Commodity Taxes

Although tariffs are likely to be the more important, it is worth noting that the optimum conditions of foreign trade are not fulfilled if domestic consumption or production is taxed. A production tax is likely to restrict exports and increase imports, while a consumption tax has the opposite effects.

By increasing domestic costs of production, a production tax will (1) restrict exports as well as domestic supply, and (2) increase imports, in case of import-competing products, since foreign costs of production do not include the tax.

The opposite effect is illustrated by American agricultural support prices, which are the equivalent of a tax on domestic consumption. They unquestionably increase export supply. Similarly, the American consumption tax on automobile tires increases export supply to the extent that it restricts domestic demand. The British tobacco tax restricts imports to the extent that it restricts domestic demand. The case of gasoline appears to be slightly more complex: an American consumption tax increases export supply, but generally higher foreign consumption taxes are likely to restrict foreign demand by a larger amount.

II

A. Direct Effects

Graphic Partial Equilibrium Analysis

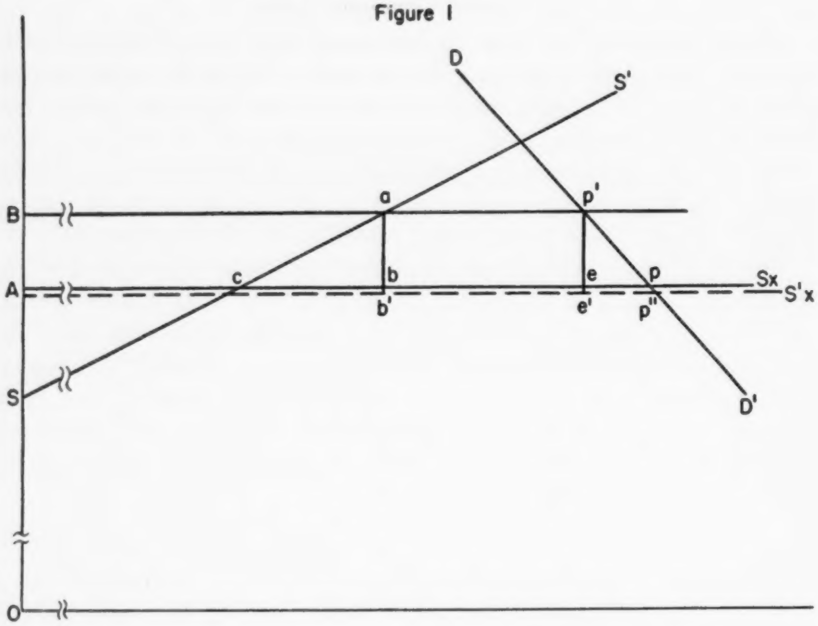
We return now to a more detailed analysis of the effects of undertrading. If we assume, as in an earlier case posed, that the United States Government imports natural rubber in such quantities as to keep the domestic price ten per cent above the world price:

(1) domestic consumption of natural rubber is restricted,
(2) domestic production of chemical rubber is stimulated,
(3) the world price of rubber falls slightly, shifting the terms of trade against exporting countries, which stimulates foreign consumption in third countries, and
(4) a profit or revenue is produced on the surviving volume of imports.

These separate effects are shown clearly by graphic analysis in figure one. Qualitative differences in raw rubber are abstracted from in order to simplify the diagram. DD′ is aggregate American demand for raw rubber, both chemical and natural. S is the American supply schedule of chemical rubber. Sx is world export supply of natural rubber.[10]

[10] A flat supply curve may, perhaps, be justified for the market period of a season's harvest. This special case is introduced to simplify the initial diagram. The general case of increasing costs in all countries is shown in figure 2. By redefining the supply curves, figure 2 can easily be adapted to the present problem.

Figure I



Under free trade, the price of both chemical and natural rubber is at p, where American demand for Ap units is satisfied by domestic production of Ac plus imports of cp. When a ten per cent price spread is introduced, the American price rises to p′, while world price falls to p″. Demand is then supplied by production of Ba plus imports of ap′. Imports are reduced by cb plus ep, the production-expanding and consumption-contracting effects, respectively. This decline of American import demand reduces the world price slightly from p to p″, the terms of trade effect. (World supply, then, becomes S′x.)

In old-fashioned terms, which are simple and familiar and may, perhaps, be justified as an approximation, the production loss from less efficient use of resources is triangle abc.[11] Since the area under the supply curves represents costs, triangle abc is the additional cost of substituting high-cost domestic production for imports.

Similarly, triangle p′pe represents the consumption loss, which will be developed more fully in explaining the indirect effects.

[11] In Marshallian analysis, starting at the free trade equilibrium price, p, the consumers' surplus is the area above the price line Ap and below the demand curve. The corresponding producers' surplus is AcS, the area above domestic costs and below the price line Ap.

At the state-trading price, p′, consumers' surplus is the area above the price line Bp′ and below the demand curve. The corresponding producers' surplus is BaS, the area above domestic costs and below the price line Bp′. BacA represents a redistribution from domestic consumers to domestic producers. Rectangle ap′eb is a redistribution from consumers to revenue. This leaves triangle abc and p′pe to be explained, as above.

Rectangle ap′c′b′ is the revenue effect, the upper part of which is paid by domestic consumers, while the lower part, bee′b′, is paid by foreign producers.

The production and consumption losses, abc and p′pe, respectively, will be greater, the greater the increase in price and the more sensitive are domestic production and consumption to price. On the other hand, the revenue effect will be greater, the larger the surviving volume of imports—that is, the steeper the domestic supply and demand curves.

American rubber manufacturers, faced with a ten per cent increase in the raw materials costs, would no longer stand on an equal footing with foreign manufacturers in the race for export markets. The disadvantage would restrict our exports and encourage imports of manufactured rubber products. Thus, American import demand for raw rubber would fall, owing to contraction of both domestic consumption and exports of American manufacturers. Consequently, the world price of natural rubber would decline enough to increase world consumption[12] of natural rubber correspondingly. Since the United States is, in fact, an important exporter of rubber products, as well as a large importer of natural rubber, the terms of trade effect is likely to be significant.

This graphic treatment is, of course, subject to all the assumptions appropriate to partial equilibrium analysis:

(1) Since the analysis is concerned with economic efficiency, it gives no weight to redistribution effects between consumers and producers, between factors of production, or between countries.

(2) The production effect is slightly overstated if, for example, the supply curve for natural rubber shifts owing to the effect of diminishing returns on factor costs. The analysis assumes constant factor costs.

(3) The indirect effects on trade require similar analysis and may show either gains or losses.

(4) Finally, no account is taken here of the possibility of dynamic income effects nor of imperfections owing to domestic monopoly.

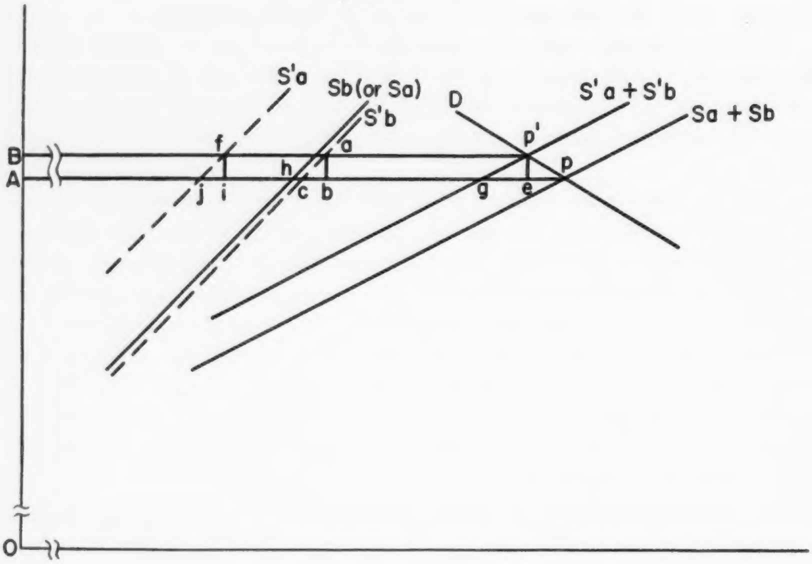
In sum, the direct effect of the above price changes is to stimulate American production of chemical rubber by restricting domestic consumption of natural rubber. But the indirect effect on foreign trade in manufactured rubber products works in the opposite direction. Domestic production for export would be restricted, and high-cost foreign production would expand because of an artificial advantage in raw material costs.

B. Indirect Effects

The indirect effect of higher American raw material costs on foreign trade in manufactured rubber products is shown graphically in figure two. D is the import

[12] And eventually to decrease world production, an adjustment not shown by this special case.

Figure 2



demand for rubber tires of a third country which does not produce tires. Sb is the British export supply, based on the international free-market cost of raw rubber.[13] Under this condition, it is convenient to assume that the American export supply curve, Sa, happens to coincide exactly with that of the British, so that total supply, Sa plus Sb, available to the importing third country is exactly double the supply offered by either exporting country. This does not affect the analysis and may make it easier to see at a glance that total export supply, Sa plus Sb, is flatter than the supply curve of either country—not because of any change in costs, but simply because the total reaction to price is the sum of the two separate reactions. The aggregate supply curve, Sa plus Sb, is obtained simply by adding the British and American exports (abscissae) corresponding to each price ordinate.

At the free-market cost of raw rubber, the same to both exporting countries, the third country's demand for imports of rubber tires is Ap, which is satisfied by imports of Ah from Britain plus equal imports of hp from the United States.

Introduction of higher American raw material costs shifts the American export supply curve up and to the left, as shown by the dotted line S'a. The terms of trade effect on the world price of natural rubber, already dealt with in figure one, shifts British export supply down to the right, as shown by the new supply curve, S'b. (Note that both horizontal and vertical scales in the diagram have been broken in

[13] In figure 2, Sb may equally be regarded as the domestic production of an importing country. The common case of a country which imports from several outside sources would require adding additional supply curves to the diagram for each country.

order to enlarge the area which shows the effects of raw material prices on foreign trade in rubber tires.)

The new equilibrium price of tires is p′, where third-country demand crosses the new aggregate supply curve, S′a plus S′b. Demand of Bp′ is now satisfied by Ba imports from Britain plus ap′ (= Bf) imports from the United States. Total imports are reduced by ep. But despite this, imports from Britain expand by hb, owing to the lower cost of natural rubber and the higher price of tires, hc and cb, respectively. Imports from America, on the other hand, contract by ih, equal to total trade contraction plus British export trade expansion, ep and hb, respectively.

Triangle p′pg is composed of the consumption effect plus the production effect, p′p and p′eg, respectively, of secondary trade contraction.[14] In addition, there are redistribution effects (1) between American and British producers, and (2) from third-country consumers to producers of both countries.

The consumption effect, p′pe, is part of the loss from distorting the pattern of final consumer choice by undertrading in natural rubber. The production effect, p′eg, may be decomposed into the additional cost of producing American and British exports, fij and abc, respectively. These losses are an elaboration of, not an addition to, the consumption loss in figure one. But trade contraction in figure two would involve additional losses if rubber tires were undertraded because of taxes or price discrimination. For in that case, the social cost of imports would be less than that of domestically produced substitutes. It must be remembered that trade contraction produces a net world loss and trade expansion produces a net world gain only if the marginal value of imports exceeds marginal cost, as in figure one.

Figure two, which shows the effect of discrimination in raw materials prices on the trade of finished products, is but an example. Formally, there are sixteen possibilities which may either expand or contract secondary trade. If state trading raises the domestic price of imports and lowers the foreign price, the indirect effects are to:

(1) contract domestic exports of substitutes,
(2) contract domestic imports of complements,
(3) expand foreign exports of substitutes, and
(4) expand foreign imports of complements.

[14] At the initial price, p, the consumers' surplus is the area above the price line, Ap, and below the demand curve. The corresponding producers' surplus is the area below Ap and above the aggregate supply curve, Sa plus Sb. At the new price, p′, the consumers' surplus is reduced by Bp′pA. Bp′gA represents a redistribution from consumers to producers. Producers' surplus is now the area below Bp′ and above the aggregate supply curve, S′a plus S′b. This leaves the triangle p′pg to be explained, as above.

The redistribution effect, Bp′gA, is composed of BacA plus BfjA, the redistribution from third-country consumers to British and American producers, respectively. In addition, American producers lose the surplus between S′a and Sa which is below the price line, Ap, while British producers gain the small surplus between Sb and S′b which is below Ap.

If state trading raises the price of exports and lowers the domestic price, it will indirectly:

(5) expand domestic exports of substitutes,

(6) expand domestic imports of complements,

(7) contract foreign exports of substitutes, and

(8) contract foreign imports of complements.

Each of these eight effects are the result of undertrading.

Conversely, there may be overtrading. If a state monopoly lowers the domestic price of imports and raises the foreign price by overtrading, the indirect effects are exactly the same as items (5) to (8) above. But if a state monopoly lowers the price of exports and raises the domestic price by overtrading, the indirect effects are exactly the same as items (1) to (4) above.

In each case, if secondary trade is restricted in any way, trade expansion will produce a net world gain and trade contraction will produce a net world loss, which must be added to the primary effects. For if substitute or complementary products are undertraded, the excess marginal value of imports over cost means that secondary trade expansion is beneficial and secondary trade contraction is harmful. Conversely, in the more unusual case where secondary trade is subsidized, secondary trade expansion will produce a net world loss and secondary trade contraction a world gain. For if substitute or complementary products are overtraded so that the marginal value of exports is less than marginal cost, secondary trade expansion is harmful and secondary trade contraction is beneficial.

THE IMMUNITIES OF THE STATE AND GOVERNMENT ECONOMIC ACTIVITIES*

VERNON G. SETSER†

INTRODUCTION

It is the purpose of this discussion to present a general account of the developmental tendencies and present status of immunities of the state—that is, the exemption of the state, its government, or its instrumentalities from legal liabilities to which private persons or associations of such persons are subject—with special reference to the relationship of such immunities to the growing participation of the state in economic pursuits that in the great majority of communities are carried on principally by private persons. Although the subject is essentially a legal one, it has aspects of significance for the political scientist, for the economist, and for the intelligent citizen in any walk of life who is concerned with furthering equality of opportunity and with suppressing or modernizing obsolete doctrines or practices that hinder the development of society in accordance with its best ideals and principles. Despite the broad implications of the problem, however, any discussion must, perforce, rely almost entirely upon legal literature, for the subject has been little considered by other than the legal profession. The present article seeks to provide a reasonably accurate general picture, but without pretense at being a technical legal essay.

The immunities of the state that are of significance in the consideration of state trading and state economic activities generally may conveniently be dealt with under three headings: (1) immunity from taxation; (2) immunity from regulatory laws; and (3) immunity from jurisdiction of the courts. The third heading is probably the one that covers what are generally regarded as the most serious problems; at any rate, jurisdictional immunity has received by far the most attention. Immunity of state instrumentalities from taxation is recognized as creating troublesome conditions, particularly in the United States, where a conflict in state-federal relations is involved. With respect to the second category, about all that can be said is that such immunities are known to exist, that they could create problems of considerable magnitude, but that the subject has received little attention from any quarter.

Many lawyers and publicists of a liberal bent find most immunities intolerable because they violate the concept of legality and the ideal of justice. They are con-

* The views expressed in this paper are those of the writer only, and they should in no way be imputed to the United States Department of State.

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cerned primarily with the fact that the escape of the state instrumentality from the normal jurisdiction of the courts results in a denial of justice for the person who has suffered from violation of contract or from tort at the hands of the immune entity. Granted that there now remain few classes of cases that cannot somehow and to some extent be prosecuted against the state, there is still concern that the manner in which immunities have been restricted leaves the probability of deficiencies in the application of justice—such as unjustifiable delays, procedures that are unfair or discriminatory against the private litigant, frustrating requirements of proceeding in an inconvenient forum, and procedural rules that weight the scales to the advantage of the state. Undoubtedly, considerations deriving from the ideal of justice, emphasizing that the principle of equality before the law requires that agencies of the state must not be above the law, have been most influential in bringing about, often by means of judgments of the courts, the extensive limitations that have been widely imposed upon the jurisdictional immunities of the state.

In the context of the problems resulting from the immense expansion of state economic enterprise, however, broader bases appear for objection to state immunities than the mere difficulty of individuals in obtaining justice. State enterprise versus private enterprise has become one of the major conflicts of our time. In those areas where the two must function side by side, the establishment and maintenance of competitive equality is a matter of some importance. Extension of jurisdictional immunity to a public enterprise may make it more difficult for the competing private enterprise to live. The enjoyment of tax immunity by a public enterprise not only subjects the taxpaying competitor to the risk of direct injury, but may tend to increase the tax burden upon all private enterprise. Exemption of state instrumentalities from general regulatory laws could also increase the load that private competition must carry.

The interests of the community affected by the activities of the public and private enterprise are also implicated, as is the welfare in certain respects of the state itself. The jurisdictional immunities of the government instrumentality may discourage private firms from doing business with it. It seems that doubt about the means for the settlement of disputes is one of the minor factors, for example, that militates against improvement in the commercial relations between the United States and the Soviet Union. The nonliability to taxes of government-controlled economic entities results in the constriction of the tax base available for the support of governmental and social services of affected communities. David E. Lilienthal, successful manager of the Tennessee Valley Authority, considered the subjection of the public enterprise to the jurisdiction of the courts in the normal way as highly desirable from the standpoint of the enterprise's own welfare and efficiency. "Further," he wrote,[1]

> the ability of a Government enterprise to enter into firm commitments is dependent on the applicability to it of the ordinary legal procedures which private businesses follow in

[1] Lilienthal & Marquis, *The Conduct of Business Enterprises by the Federal Government*, 54 HARV. L. REV. 545, 568 (1941).

their contractual and other relations. . . . Where the Government engages in business activity, the existence of those same relationships [ordinary legal relationships between litigants and between lawyer and client] is essential, since protection of private rights requires amenability of the agency to suit, while the efficient conduct of its affairs similarly necessitates a correlative right on the part of the agency to sue and make settlements.

In case international intercourse should be prejudiced by the uncertainties, inequalities, and outright hindrances resulting from the special advantages derived by state enterprises from their immunities, the latter might be regarded as falling into the category of barriers to international trade, along with excessive tariffs, quantitative restrictions, cartels, etc.

What is the *raison d'être* of state immunities and the explanation of their survival into a period in which they run counter to important aspirations and objectives of society? Their origins have been traced to medieval concepts, although it appears that even in the Middle Ages, with that period's primitive governmental institutions, they were not applied as completely or endorsed as fully as some advocates and judges have apparently regarded as proper in more recent times. All societies, presumably, have considered the state and its government, possibly because government is regarded as the author of the laws and the source of justice, as not properly subject to the same liabilities, procedures, and penalties as private persons. Certainly, when governmental functions were limited largely to military affairs, police matters, administration of justice, maintenance of primitive communications, and providing the financial means for such operations, the small number of contacts between government and governed minimized the importance of the facile settlement of disputes between the two. But in the Roman Empire, where governmental authority was exalted to the highest degree, the state in its property relationships was suable in the courts. In most of the countries of Continental Europe, the influence of the Roman law, together with that of principles of early Germanic law stressing rights of the individual against the governing authority and of similar principles derived from early modern concepts of natural law, have supported the maintenance of limitations upon claims of the sovereign to immunity and have facilitated marked progress toward an acceptable degree of equality in justice for state instrumentalities and private enterprise.

In the countries that have inherited the English common law, however, immunities of the sovereign and attitudes toward them have developed in a different way. Borchard has written:[2]

Only in democratic England and republican America do we find the absolutist metaphysics of divine right and sovereign immunity arrayed in the full regalia of their theological vestments, reincarnating for a twentieth century society the ancient credo of Bodin and Hobbes.

He might well have included the members of the British Commonwealth in his statement. But it should be recalled that since he wrote, the common-law countries

[2] Borchard, *Governmental Responsibility in Tort*, 36 YALE L. J. 1, 3 (1926).

have made commendable progress in a liberal direction. It has been frequently said that the great respect for sovereign immunity in the common-law countries derives from the principle that "the King can do no wrong." At any rate, the rule developed in England that the King was not subject to the jurisdiction of the courts, except to the extent and in the manner to which he would consent; and the extent and the manner were severely circumscribed. This rule influenced the early decisions of the United States courts, since it was considered a principle of the common law. But later in this country, decisions supporting immunity from jurisdiction came to be justified on more rational grounds—namely, that protection of government and its officials from interference and annoyance through their being subjected to suit was necessary for the efficient carrying out of the transcendently important functions of government.

The immunities appertaining to foreign states have had a somewhat different origin and development, although the essential elements are related. They have been more generally recognized and respected than those of the territorial sovereign, and governments and courts have been more reluctant to come to grips with the need for limitation. They also seem to have originally been related to the prerogatives of the personal sovereign. In modern times, however, they have been justified mainly on the grounds that all states being equal and independent, submission of one state to the jurisdiction of another would be derogatory to the former's dignity and independence, and that foreign relations could not be properly conducted by the executive authorities if court jurisdiction were asserted.

Since there has been relatively little attention given to the subject of the immunities of state instrumentalities from tax liability and from regulatory legislation applicable to private enterprises, there is little information available as to the theories upon which their justification must rest. Doubtless, state instrumentalities engaging in economic activities have appeared to be analogous to such instrumentalities engaged in purely governmental activities, and the imposition of taxes or the enforcement of regulations designed to control private enterprises have been considered as unthinkable in the former case as in the latter. Moreover, it is difficult to avoid the conclusion that as a general rule, the policy of exemption from taxation is logically inherent in the original decision for the government to enter the activity. There is probably little justification from an economic standpoint, and less from the administrative, for an enterprise that depends upon the state for investment funds, and must either plow back its surplus earnings or cover them into the treasury, to segregate a portion of them for return in the form of tax payments. The only fundamental difficulty arises when there are autonomous tax jurisdictions, and the authorities in the lower echelons are precluded by state ownership from tapping the resources of the enterprise for the support of the public services for which they are responsible.

Once established, immunities of the state have tended to linger on for many reasons. Precedents and vested interests have been established that are difficult to change. What may well be referred to as the fiscal-mindedness of legislators and

executive officials has been and still is a major defense of some aspects of state immunity. For example, the slowness of the states of the United States to make tort claims a subject for adjudication by the courts has been due to fear of the cost to the state of awards—a fear that the experience of those states with liberal tort-claims legislation seems to have proved unfounded.

I

IMMUNITY FROM TAXATION

The situation with respect to the immunity of state instrumentalities from taxation varies greatly from country to country, and within countries, as concerns different classes of activities and types of taxes, without much indication of any clearly definable systems or logical rules. As to taxation applicable directly to instrumentalities of foreign states, there seems to be more of a common pattern; but even here, not all the signs point in the same direction. As in the case of immunity from jurisdiction, a substantial body of opinion is highly critical of tax immunities, particularly where it can be argued that they restrict the tax base substantially or where they extend to commercial activities in competition with private enterprise.[3]

In the United States, different principles apply as regards taxation of federal instrumentalities by the states and state instrumentalities by the federal government. The federal government, of course, seldom applies taxes to its own activities, however organized, although there is no question of its power to do so. In a line of decisions beginning with ***McCulloch v. Maryland*** in 1819,[4] the federal courts, seeking to protect the national government against interference by the states, established firmly the rule that no state tax could be applied directly to a federal activity. They even went much further and expanded the doctrine to prohibit any state tax, whatever its incidence, that resulted in any significant economic burden upon the federal government. This meant, for example, that private contractors on government projects—indeed, any private concern or citizen performing services for the Government—could share the immunity. The effect of the rulings was so restrictive upon the taxing power of the states that strong pressure developed for a change. Within the past half century, the Supreme Court, in a new line of decisions, relaxed the doctrine protecting private interests, so that only state taxes whose legal incidence was upon the federal government were forbidden, unless greater immunities were authorized by statute; and a series of decisions handed down in 1958 has gone even farther in

[3] The Hoover Commission's hostility toward United States Government "business enterprises" was based in part upon their immunity from taxation. "The Government business-type enterprises, except in a few instances, pay no taxes, and pay little or no interest on the capital invested. . . . Moreover, in addition to the fact that most of them pay no taxes, they deprive the Government of taxes which would otherwise be paid by private enterprise if it conducted these operations. Therefore their claims of financial success are often wholly invalid; and, worse, with the advantages they receive from the Government, they are unfair competition." 4 U.S. COMM'N ON ORGANIZATION OF THE EXECUTIVE BRANCH OF THE GOVERNMENT, BUSINESS ENTERPRISES xii (1955).

[4] 17 U.S. (4 Wheat.)* 316 (1819).

limiting the immunity of private concerns engaged in government work.[5] In certain circumstances, too, Congress has seen fit to mitigate the local effects of tax immunity by providing for payments in lieu of taxes, as, for example, in the case of the Tennessee Valley Authority.[6]

On the side of the states, the instrumentalities of the state are normally immune from taxes of the state itself. There appears to be no constitutional rule preventing a state from taxing the instrumentality of another state if it should enter the jurisdiction, but no case of such taxation has come to the attention of the writer. The principal problem with regard to the immunity of state activities from taxation has arisen from relationships with the federal government. The federal courts have tended to protect the states on the same grounds—preventing interference of one sovereignty with another—that have provided the basis for exemption of federal activities from state taxes, but not to the same extent. The decisions have distinguished between the essential governmental activities of a state and its activities of a proprietary nature, or of a type normally carried on by private enterprise.[7] Such state activities as the sale of alcoholic beverages and mineral water have, for example, been held subject to federal taxation.[8] According to Ratchford, the Supreme Court, under prevailing doctrines, does not allow the following forms of taxation to either the federal government or the states:[9]

> (1) taxes directly upon an essential government activity; (2) property taxes upon property owned by governments or governmental agencies; (3) property taxes resting directly or indirectly upon government bonds; (4) excise taxes upon sales directly to governments or governmental agencies; (5) income taxes upon the interest on government bonds.

In Great Britain, as in the Commonwealth generally, the traditional principle that the Crown is not deemed to be bound by any statute, unless there is clear evidence that it was intended to be bound, has operated to exempt public instrumentalities from taxation. But in some of the legislation establishing the entities to operate the nationalized industries, it is specifically provided that they shall be liable for both general and local taxes.[10]

In Canada, federal instrumentalities are, by provision of the British North America Act, immune from provincial property taxes, and provincial instrumentalities

[5] See Ratchford, *Intergovernmental Tax Immunities in the United States*, 6 NAT'L TAX J. 305 (1953); Powell, *The Waning of Intergovernmental Tax Immunities*, 58 HARV. L. REV. 633 (1945), and *The Remnant of Intergovernmental Tax Immunities*, *id.* at 757. The recent decisions referred to are United States v. City of Detroit, 355 U.S. 466 (1958); United States v. Township of Muskegon, 355 U.S. 484 (1958); and City of Detroit v. Murray Corp. of America, 355 U.S. 489 (1958).

[6] 54 STAT. 626 (1940), 16 U.S.C. § 831(l) (1952).

[7] See Ratchford, *supra* note 5; Rice & Estes, *Sales and Use Taxes as Affected by Federal Governmental Immunity*, 9 VAND. L. REV. 204 (1956).

[8] South Carolina v. United States, 199 U.S. 437 (1950); Ohio v. Helvering, 292 U.S. 360 (1934); New York v. United States, 326 U.S. 572 (1945).

[9] Ratchford, *supra* note 5, at 331-32.

[10] See WOLFGANG FRIEDMANN, LAW AND SOCIAL CHANGE IN CONTEMPORARY BRITAIN 63, 206-09 (1951).

from federal property taxes.[11] The policy has been adopted, however, that Crown corporations, both federal and provincial, should make "fair and equitable" payments in lieu of taxes to municipalities. The Dominion Government has made its "proprietary corporations," such as Trans-Canada Airlines, liable for the federal income tax. There is no constitutional necessity, apparently, for the provinces to exempt their own instrumentalities from taxation. But the province of Saskatchewan, which has gone far in the socialization of economic activities, does not, for example, make its enterprises liable for municipal taxes, although grants in lieu of taxes are allowed.[12] Provincial corporations are not exempt from federal sales taxes, although departments of the provincial governments proper are immune.

The immunity status of government instrumentalities in Australia is particularly confusing,[13] and the subject is of unusual interest because of the extent to which the state participates in economic activities. It appears to be the general policy to exempt government-controlled enterprises from taxation, the argument being that taxation would accomplish little, except complicate government bookkeeping. There is, however, no uniformity. The government-owned railway system, for example, is exempt from taxation, but the entity that operates Trans-Australian Airlines is not exempt. The different treatment is probably due to the fact that the railway system is a government monopoly, while Trans-Australian Airlines operates in competition with privately-owned lines. The Aluminium Industry Commission is exempt from state taxes but subject to national taxes other than the income tax. The Shipping Board is exempt from national taxes but subject to state taxes. In New Zealand, the degree of direct competition with private enterprise seems to furnish the criterion for the imposition of taxes.[14] A few enterprises, such as the National Airways Corporation and the Bank of New Zealand, are fully liable. South African public enterprises are not usually subject to taxation, the view being taken, as in Australia, that assessment of taxes merely necessitates an additional bookkeeping operation.[15]

Among many of the principal countries of the western part of Continental Europe, there appears to be more of a common pattern with respect to the tax treatment of government instrumentalities.[16] In Italy, France, West Germany, and, to some extent apparently in Sweden, entities of the state engaged in economic activities are organized and treated in much the same way as private enterprises, and many of

[11] British North America Act of 1867, 30 & 31 VICT. c. 3. See Hodgetts, *The Public Corporation in Canada*, in WOLFGANG FRIEDMANN (ED.), THE PUBLIC CORPORATION 51, 67, 69-70 (1954).

[12] See Blakeney, *Saskatchewan Crown Corporations*, in *id.* at 91, 99.

[13] See Sawer, *The Public Corporation in Australia*, in *id.* at 1, 33-36.

[14] See Webb, *The Public Corporation in New Zealand*, in *id.* at 267, 295-96.

[15] See Price, *The Public Corporation in South Africa*, in *id.* at 302, 314.

[16] See Drago, *The Public Corporation in France*, in *id.* at 108, 126, 130; Friedmann & Huffnagel, *The Public Corporation in Germany*, in *id.* at 138, 145; Muggia, *The Public Corporation in Italy*, in *id.* at 241, 257; Strömberg, *The Public Corporation in Sweden*, in *id.* at 324, 335. For an enlightening discussion of the problems of obtaining exemption of United States defense activities abroad, see Efron & Hill, *Foreign Taxes on United States Expenditures*, 23 U. CIN. L. REV. 371 (1954).

them are liable to taxation in like manner to private enterprises. Special exceptions exist, of course, where special tax treatment or full exemption is provided, usually in the legislation establishing the instrumentality, but the effort has been made, seemingly with some success, to assimilate many public enterprises to private enterprises in matters of taxation.

Of especial interest is the subject of tax immunity within the Soviet Union.[17] Since all economic activity of any consequence is state activity, the solution of the problem of providing income for local governmental administration was of major consequence. That solution was not dissimilar to the solution of the like problem in capitalist countries. Except in certain fields of activity judged to be of special economic or strategic importance, and, therefore, exempted from local taxes, such as railroads, civil aviation, and the mining of certain highly valued metals, the public corporations that operate the economy are taxed by the local soviets on the land and buildings used. In addition, the central government levies an income tax and a turnover tax upon the corporations. The latter is applied to products at time of manufacture, or, in the case of corporations in the service trades, to operations as measured by gross income. More than two-thirds of the budget of the central government is financed by this tax. The rate of income tax is ten per cent of net income, unless net income exceeds planned profits and construction requirements of the corporation, in which case, all surplus income is payable as an excess profits tax.

It appears to be the general practice of governments to accord immunity to instrumentalities of foreign states in the case of taxes the incidence of which would be directly upon such instrumentalities, although specific evidence of the tax status of state enterprises carrying on activities in countries other than the United States in competition with private enterprise is not readily available. There appears to be a definite tendency toward the development of a rule of international law supporting immunity for movable property owned by a foreign state, and possibly for real property, or at least for real property held for public use.[18]

In the United States, the income of foreign governments from any source within the country is exempted from the federal income tax.[19] Such governments, their agencies, and officers have, in the past, also been exempted from certain federal excise taxes in the case of transactions paid for by the foreign government.[20] There have been numerous inconsistencies in United States practice, however. In 1922, for example, a dispute arose over the taxation by the United States of a Maine corporation wholly owned by Nicaragua, whose corporate purpose was the operation of railways and steamship lines of Nicaragua. The initial United States position was that the corporation was a separate legal entity of American nationality and was not

[17] See Hazard, *The Public Corporation in the U.S.S.R.*, in WOLFGANG FRIEDMANN (ED.), THE PUBLIC CORPORATION 374, 394-95 (1954).

[18] See 2 CHARLES CHENEY HYDE, INTERNATIONAL LAW 847 (1945); Bishop, *Immunity from Taxation of Foreign State Owned Property*, 46 AM. J. INT'L L. 239, 240, 256 (1952).

[19] INT. REV. CODE OF 1954, § 892.

[20] See Fairman & King, *Taxation of Friendly Foreign Armed Forces*, 38 AM. J. INT'L L. 258, 266 (1944); 4 GREEN H. HACKWORTH, DIGEST OF INTERNATIONAL LAW 775 (1942).

entitled to immunity as a part of the government of a foreign state. After an interval of several years, however, the decision was taken to refund the taxes collected.[21] In another case, occurring in 1933, however, the Treasury Department refused any concession. It involved a request that the Chinese Government Agency in New York, purchasing agent for the Government of China, be exempted from excise taxes affecting the official business of the Agency. In refusing the exemption, the Treasury Department contended that the Agency was not entitled to immunity under international law, and, while it might be proper government policy to accord exemption, that policy should be expressed by means of a treaty or statute.[22]

The opinions of state courts and officials have by no means given uniform support to the immunity of foreign states. Restrictive rulings have been made in certain cases, and in California, the attorneys general have sought to distinguish property for "public" use from other property of foreign states for application of the immunity rule.[23] The principal American court decision on the subject was rendered by the Court of Appeals of Kentucky, in 1923.[24] The suit concerned the attempt of county authorities to tax certain tobacco belonging to the French tobacco monopoly. The court related the matter of immunity from taxation to that of immunity from suit, pointing out that even if the tax were upheld as legal, payment could not be enforced, since the French Government was not suable. The effect of a decision against the French Government was also stressed. Said the court, "We know of nothing more calculated to degrade the dignity of an independent nation than for another to attempt to exercise over it the soverign right of taxation."[25] In a few court cases in other countries, immunity has been denied to property owned by foreign states, but the tendency seems to be to accord immunity as to property taxes.[26]

In a series of commercial treaties negotiated between 1948 and 1956,[27] the United States included a provision containing a mutual waiver of immunity from taxation for publicly-owned or controlled enterprises of either treaty partner engaged in commercial, industrial, shipping, or other business activities within the territories of the other. The primary purpose of these treaty provisions was to provide an equitable rule to apply in the case of foreign state enterprises established in the United States pursuant to other provisions of the treaties. These clauses are not considered to be of such a nature as to impose taxes where the law exempts foreign government instrumentalities, but they would undoubtedly bar claims to immunity from a treaty state if imposition of taxes upon foreign state enterprises were provided by law.

[21] See 2 HACKWORTH, *op. cit. supra* note 20, at 475-76 (1941).

[22] See 2 *id.* at 482-83 (1941).

[23] See Bishop, *supra* note 18, at 245-50.

[24] French Republic v. Board of Supervisors, 200 Ky. 18, 252 S.W. 124 (1923). See also Bishop, *supra* note 18, at 240-41.

[25] French Republic v. Board of Supervisors, 200 Ky. 18, 22, 252 S.W. 124, 125 (1923).

[26] See Bishop, *supra* note 18, at 255.

[27] See note 92 *infra*.

II

IMMUNITY FROM REGULATORY LAWS

Immunity of governmental instrumentalities from regulations governing private persons and entities is derived in the common-law countries from the principle that statutory provisions that would have the effect of divesting pre-existing rights are not applicable to the state unless a clear legislative intent to subject it thereto is shown. In the United States, the courts have applied this rule to the advantage of the federal authorities[28] in a number of important cases. The United States has, for example, been held to be exempt from the requirements of the law prohibiting the issuance of injunctions in labor disputes,[29] from provisions of the Bankruptcy Act,[30] and, as landlord, from rent control regulations in the District of Columbia.[31]

Under the federal supremacy doctrine, the states are not permitted to apply regulations, under their police power, that would interfere with federal activities. It has been held, for example, that a contractor need not obtain a state license when constructing federal facilities within a state;[32] that the United States may build a dam within a state without regard to a state law making all dam construction subject to approval by the state engineer;[33] that a federal soldiers' home is exempt from state regulations regarding the serving of food;[34] and that the Department of Agriculture may distribute fertilizer to farmers without complying with state inspection laws.[35]

In the United Kingdom, the immunity of the Crown from statutory regulations has been confirmed in a number of fairly recent court decisions, among them a case involving failure to comply with landlord and tenant (rent control) regulations. A case similar to the latter has also been reported from Australia. In India, a few years ago, a municipal enactment of Bombay authorizing the construction of drains through private and municipal property was considered not to oblige the Crown to comply with respect to its property.[36]

The subject of the immunity of state instrumentalities from the applicability of general regulations in the countries of Continental Europe does not appear to have been specifically studied. Presumably, however, under the doctrine of the assimilation of public commercial corporations to the status of private corporations, the former would, in most cases, be subject to the regulations applicable to similar private entities.

[28] See Note, *Immunity from Statutes of Limitations and Other Doctrines Favoring the United States as Plaintiff*, 55 COLUM. L. REV. 1177 (1955).
[29] United States v. UMW, 330 U.S. 258 (1947).
[30] *In re* Greenstreet, 209 F.2d 660 (7th Cir. 1954).
[31] United States v. Wittek, 337 U.S. 346 (1949).
[32] Miller v. Arkansas, 352 U.S. 187 (1956).
[33] Arizona v. California, 283 U.S. 423 (1931).
[34] Ohio v. Thomas, 173 U.S. 276 (1899).
[35] Mayo v. United States, 319 U.S. 441 (1943).
[36] See WOLFGANG FRIEDMANN, LAW AND SOCIAL CHANGE IN CONTEMPORARY BRITAIN 266-68 (1951).

III

IMMUNITY FROM JURISDICTION OF COURTS

As concerns immunities from the jurisdiction of the courts, it is the immunity of the territorial sovereign within his own domain, not the immunity of foreign states, that possesses the greatest potential for adding to the problems arising from state activity in the economic sphere. State trading is obviously of greater impact on the domestic than on the international side. It is at home that the powers of the state are greatest, both with respect to protecting its own privileges and with respect to competition with private enterprise. International intercourse is much more vulnerable to injury from impediments established by the local sovereign to adjudication in his own courts of disputes arising, for example, from his own purchases of foreign products, sales of national products, and other transactions having effects beyond his own borders or upon aliens. One must make haste, however, to emphasize that those impediments are no longer of unlimited proportions, and that governments and tribunals almost everywhere have recognized the implications of the proliferations of state enterprise and acted, to a greater or less extent, to redress the balance.

The present situation of the United States Government with respect to immunity from suit is far removed from that once prevailing, when the private act of Congress or the frequently frustrating proceedings against an individual government officer who might be held personally liable was the only recourse of a claimant. Beginning with the Court of Claims Act of 1855, which was greatly strengthened by legislation passed in 1863 and modified by the Tucker Act of 1887 (giving the federal district courts concurrent jurisdiction with the Court of Claims in cases involving sums of $10,000 or less),[37] and capped by the Federal Tort Claims Act of 1946,[38] a creditable body of legislation has been built up, establishing a system under which a very great proportion of disputes between the people and the Government can be adjudicated in a way quite comparable to that prevailing in the case of disputes between private persons. But the system is by no means perfect; there are too many limitations, exceptions, and uncertainties in the law. Contract claims amounting to more than $10,000 can be prosecuted only in Washington, D. C., which may be an inconvenient forum for many in this large country. An alien may have access to the Court of Claims only upon proof that the country of which he is a national permits United States citizens to prosecute claims against its government in its courts.[39] Although such a rule has nothing to do with justice, it is only moderately burdensome in most cases, since nearly all countries can doubtless make an acceptable showing of reciprocity. But the system for the prosecution of claims relating to contract and to property is generally regarded as good.[40]

[37] 24 STAT. 505, 28 U.S.C. § 1346 (1952).

[38] 60 STAT. 842, as amended, 28 U.S.C. §§ 2671-80 (1952).

[39] 62 STAT. 976 (1948), 28 U.S.C. § 2502 (1952). See *Developments in the Law—Remedies Against the United States and Its Officials*, 70 HARV. L. REV. 829, 875-84 (1957), for a discussion of remedies under the Tucker Act.

[40] See HARRY STREET, GOVERNMENTAL LIABILITY 11-12 (1953).

The Federal Tort Claims Act has, however, been described as "riddled with exceptions."[41] Its major provision that "the United States shall be liable . . . in the same manner, and to the same extent as a private individual under like circumstances" is, in fact, deceptive.[42] Specific exceptions from the classes of torts for which claims may be prosecuted include, for example, losses or injuries resulting from negligence in the transmission of mail, from "discretionary" actions of officers, and from a long list of intentional torts, such as assault and battery, false imprisonment, and malicious prosecution. Although suits by aliens are not precluded by the Act, actions on claims arising in foreign countries are specifically excluded. Provision has been made by separate legislation, however, for administrative settlement of such claims within specified limitations as to amounts.[43] Jury trial of claims against the United States is not permitted, which, in itself, constitutes a substantial protection for the state over many private defendants. Government corporations are much less likely to be accorded immunities by the courts than are other types of instrumentalities.[44]

There are also certain significant elements of traditional sovereign immunity that the federal government has not surrendered in the legislation and which the courts tend to protect, at least in part.[45] The remedies that the legislation provides are limited substantially to monetary damages. The cases in which affirmative remedies —mandamus, injunctive relief, and specific performance—will be provided are few. Also, the Government may enjoy advantages in the nonapplication to it of certain procedural rules, such as discovery of documents. As plaintiff, it is exempt from statutes of limitations; and if it loses a suit, it normally does not have to pay costs (although successful tort claimants may be allowed costs other than attorney's fees). As to enforcement of judgments, sovereign immunity remains intact. Execution against public property is still unacceptable; the carrying on of the public business would be interfered with if such property were seized.

The states have, in general, made much less progress than the federal government in extending governmental liability for breach of contract and injuries to persons and property. More progress has been recorded with respect to contractual liabilities than

[41] HENRY M. HART & HERBERT WECHSLER, THE FEDERAL COURTS AND THE FEDERAL SYSTEM 1143 (1953).

[42] 60 STAT. 842 (1946), 28 U.S.C. § 2674 (1952). See *Developments in the Law—Remedies Against the United States and Its Officials*, 70 HARV. L. REV. 829, 889-92 (1957); Davis, *Tort Liability of Governmental Units*, 40 MINN. L. REV. 751, 779-91 (1956); Note, *Judicial Limitations under the Federal Tort Claims Act*, 38 MINN. L. REV. 634 (1954); Gellhorn & Lauer, *Federal Liability for Personal and Property Damage*, 29 N.Y. U. L. REV. 1325 (1954); James, *Tort Liability of Governmental Units and Their Officers*, 22 U. CHI. L. REV. 610 (1955).

[43] 70A STAT. 154 (1956), 10 U.S.C. § 2734 (Supp. V, 1958); 49 STAT. 1138 (1936), as amended, 31 U.S.C. § 224a (1952); 70 STAT. 890 (1956), 5 U.S.C. § 170g (Supp. V, 1958). See also Davis, *supra* note 42, at 760-61; Gellhorn & Lauer, *supra* note 42, at 1342-44.

[44] See *Developments in the Law—Remedies Against the United States and Its Officials*, 70 HARV. L. REV. 829, 840-48 (1957).

[45] See STREET, *op. cit. supra* note 40, at 131-42, 166-82; Note, *Judicial Limitations under the Federal Tort Claims Act*, 38 MINN. L. REV. 634 (1954); *Developments in the Law—Remedies Against the United States and Its Officials*, 70 HARV. L. REV. 829, 846-74, 923-35; Note, *Immunities from Statutes of Limitations and other Doctrines Favoring the United States as Plaintiff*, 55 COLUM. L. REV. 1177 (1955).

with respect to torts.[46] Settlement of claims by private legislative act is still a common practice, with its uncertainties and likelihood of logrolling, favoritism, and graft.[47] The methods for settlement of claims employed by the states fall generally into three classes: action in individual cases by the legislature; consideration by an administrative board, sometimes with settlement authority, sometimes with authority merely to report and recommend to the legislature; and adjudication by a court.[48] The constitutions of several states forbid suits against the sovereign. New York has yielded much of its immunity, and its court of claims has wide jurisdiction in both contract and tort. Several other states have adopted fairly modern legislation in the subject matter.[49]

The evolution of law and practice with respect to state responsibility in the United Kingdom and the countries of the Commonwealth during the last century has been similar to that in the case of the federal government in the United States.[50] To begin with, only the narrowly circumscribed path of proceeding by petition of right was available to those who thought they had a claim against the Crown. There was, of course, the possibility of actions against individual officers of the Government, which often offered little hope of satisfaction, and the possibility that a public corporation would be held not to possess the immunities of the Crown. The petition of right could be productive only in case the Attorney General, who possessed unlimited discretion in the matter, should grant a "fiat." Venue was highly restricted, being originally limited to the Court of Exchequer. Generally, only cases involving recovery of or compensation for property that had passed into the possession of the Crown and contract could be pursued through petition of right. Aside from certain very limited classes relating to property, the Crown was not actionable in tort. Procedures were somewhat simplified by the Petition of Right Act of 1860,[51] but the system was not substantially altered until 1947. The Crown Proceedings Act of that year[52] abolished the petition of right and made the Crown subject to private law liabilities, including liability in tort and suit in the ordinary courts, to a very great extent. These liabilities are limited in many respects in much the same way as in the case of the federal government in the United States, except that tort liability is subject to fewer specific exceptions in Great Britain.[53] There are many uncertainties as to the application of the Act, due to lack of precision in the drafting and because there has not yet been time for the courts to interpret it for many

[46] Among the more recent surveys of immunity practice among the states are Davis, *supra* note 42; Note, *Administration of Claims Against the Sovereign*, 68 HARV. L. REV. 506 (1955); Note, *Sovereign Immunity of the States*, 40 MINN. L. REV. 234 (1956); Leflar & Kantrowitz, *Tort Liability of the States*, 29 N.Y. U. L. REV. 1363 (1954); James, *supra* note 42.

[47] See Note, *Administration of Claims Against the Sovereign*, 68 HARV. L. REV. 506, 509 (1955).

[48] See *id.* at 507.

[49] See *id.* at 507-17; Leflar & Kantrowitz, *supra* note 46, at 1407.

[50] See Laski, *Responsibility of the State in England*, 32 HARV. L. REV. 447 (1919); STREET, *op. cit. supra* note 40, at 1-6; Wade, *Liability in Tort of the Central Government of the United Kingdom*, 29 N.Y.U.L. REV. 1416 (1954).

[51] 36 & 37 VICT. c. 69 (N.I.).

[52] 10 & 11 GEO. 6, c. 44.

[53] See STREET, *op. cit. supra* note 40, cc. 5, 6, 7.

situations. The great commercial corporations that operate the industries nationalized since the World War II are not governed by the Crown Proceedings Act, but are liable to civil action in the same way as private corporations.[54]

Canada established a special federal court, the Exchequer Court, in 1887 to hear cases against the Dominion. Proceeding was by petition of right upon "fiat" of the Governor General, approved by the Minister of Justice. Jurisdiction extended to both contract and tort. The legislation has been progressively liberalized, and a number of important steps have been taken within the last decade.[55] In 1950, corporate Crown agencies were made subject to the jurisdiction of the provincial courts. In 1953, torts resulting from negligence and not involving claims of more than $1000 were also submitted to the jurisdiction of county or district courts. Australia preceded the United Kingdom by many years in completing its liberalization of the law regarding state liabilities.[56] The Judiciary Act of 1903[57] made it possible to sue the Commonwealth in both contract and tort without petition of right. A somewhat controversial question at present in the Commonwealth is the extent to which the numerous public corporations in the country stand under "the shield of the Crown," entitling them to the enjoyment of whatever is left of the state immunities. This is a problem that is encountered also, to some degree, in Canada and the United Kingdom. Like some of the states of the United States, and, apparently, some of the Canadian provinces, a few of the Australian states have lagged far behind the central government in surrendering their immunities. New Zealand and the Union of South Africa seem to have reached a stage of advancement approximately equivalent to that of Australia.[58]

The greatest innovations in the recognition of governmental responsibility have been produced by French judicial proficiency and resourcefulness. The individuality of the French system results from two developments: first, the establishment and growth of a system of administrative courts, separate from the ordinary civil courts and manned by judges with administrative experience, having jurisdiction over most types of cases involving the state; and, secondly, the formulation and application of new legal principles in the settlement of such cases. The system of administrative courts grew out of the decision taken during the Revolution that the operations of the state should be freed from interference by the regular courts and that the new system of law should be developed from the creative judgments of the Council of State, at the head of the administrative hierarchy in individual cases.

Special rules in the law governing government contracts have been developed by the French courts, generally giving emphasis to the paramount importance of

[54] See Wade, *supra* note 50, at 1429-30.

[55] See Hodgetts, *supra* note 11, at 65-70; French, *Rights in Contract and Tort in Relation to the Crown*, CHITTY'S L. J. 76-77 (1956).

[56] See STREET, *op. cit. supra* note 40, at 6; Sawer, *supra* note 13, at 36-42. See also WOLFGANG FRIEDMANN, LAW AND SOCIAL CHANGE IN CONTEMPORARY BRITAIN 206 *et seq.* (1951).

[57] An Act to Make Provision for the Exercise of the Judicial Power of the Commonwealth, II Commonwealth Acts, 1903-34, p. 1379, Aug. 25, 1903 (Australia).

[58] See STREET, *op. cit. supra* note 40, at 7; Price, *supra* note 15, at 312-14.

the proper carrying on of the public services, but, nevertheless, taking care to provide adequate protection of the private contractor.[59] But it is in the field of tort claims that the French have gone farthest in assuring protection for the private person.[60] The basic doctrine has been that liability rests upon fault—either the fault of the state administrative service, in which case the state is liable for damages to be determined in the administrative courts, or the personal fault of the state employee, in which case the latter is suable in the civil courts. But in distinguishing the two classes of fault, very difficult in almost any circumstances, the decisions have tended to widen the former category and narrow the latter. As a final development, the jurists of the Council of State have begun to abandon more and more the concept of fault and to hold the state liable for damages on the basis of the doctrine of risk—that is, that "the very function of the service creates a risk which must be borne by the public equally."[61] Resort to this doctrine has produced judgments that in American eyes might appear to be somewhat bizarre. For example, a restaurant proprietor was awarded damages because his business suffered on account of the blocking of a highway during public improvement work; and a claimant was indemnified when the executive authorities refused, for overriding policy reasons, to evict trespassers from the claimant's property pursuant to a court order.[62] It seems evident that France has not only come closest to the ideal of placing the state upon a plane of equality with the private person as concerns legal responsibility, but has sometimes gone further and made the state liable in cases where the private person possibly would not be. Although in France, as in most other countries, the property of the state is normally immune from execution, there seem to be certain situations in which it is possible to enforce an unsatisfied judgment against public property.[63]

The cases over which the administrative courts have jurisdiction are public law cases. Some important matters involving the state are private law matters, within the jurisdiction of the civil courts and subject to the civil code. Among these are certain types of contracts, particularly contracts not closely related to the performance of a public service. A commercial lease would be an example.[64] Of more importance from the viewpoint of those concerned with the problems of state trading is the subjection to the civil courts of a large group of state instrumentalities that perform functions comparable to those performed by private persons. A number of these industrial and commercial corporations, such as that for the operation of the Alsace potash mines, were established after World War I. Included in the group, also, are the great public enterprises that were nationalized after 1945, such as the electricity and gas industries. In nearly all respects, the legal status of these instru-

[59] See STREET, *op. cit. supra* note 40, at 100-01.

[60] See *id.* at 56-80; Jacoby, *Federal Tort Claims Act and French Law of Governmental Liability: A Comparative Study*, 7 VAND. L. REV. 246 (1954); Schwartz, *Public Tort Liability in France*, 29 N.Y. U.L. REV. 1432 (1954).

[61] STREET, *op. cit. supra* note 40, at 67.

[62] See *id.* at 67-68. See also BERNARD SCHWARTZ, FRENCH ADMINISTRATIVE LAW AND THE COMMON LAW WORLD 288-302 (1954).

[63] See *id.* at 182-83.

[64] See *id.* at 83.

mentalities, except with respect to execution against their property, has been assimilated to that of private concerns.[65]

In the other countries of West Europe, what may be described as a relatively advanced stage of recognition of the responsibility of the state has been achieved, although the situation varies from country to country, and none appears yet to have approximated, in a comprehensive range, the degree of liberalization developed in France.[66] Liability for contract seems universally accepted. In other fields, a distinction is generally made between acts of authority—that is, essential acts of government—for which no liability is assumed, and acts of management, over which civil courts exercise jurisdiction. Thus, in Belgium, the state could not be sued for damage caused by a military vehicle engaged in normal military activities, but it could be sued if the damage occurred while the vehicle was being used in distributing food to the civilian population, the former being an act of authority, the latter not. For the most part, liability for tort in all countries is based upon fault. West Germany seems to have taken a long stride toward accepting liability for acts of public authority, and Italy makes no distinction between the two categories of acts. Certain classes of state instrumentalities in West Germany are regarded as public-law entities and actionable only before the administrative courts; included in this group are the railway system and certain municipal utilities. On the other hand, a number of state economic entities, including other gas and electricity utilities and certain mining enterprises, are private-law entities and within the jurisdiction of the civil courts. The Italian state is normally actionable in the civil courts, although suability in the administrative courts may be provided for in certain circumstances; and this applies generally to the numerous public economic entities which are said to account for about half of all productive enterprise in Italy.

In Latin America, the law of state liability has developed along lines similar to the law of Continental European countries. Generally, the law regards the state as a corporate entity and subject to the jurisdiction of the civil courts in much the same way as any other juristic person. As in Continental Europe, distinction is made between acts of authority and acts of management. In Argentina, the development of liability doctrine has differed from that in other countries, the rationale being comparable to that in the common-law countries that suit must depend upon consent. But a law of 1900 provides that civil action may be initiated without prior legislative consent.[67]

It has been said that "unlike other legal systems, the Soviet legal system does not know the notion of immunity of the domestic government and its instrumentalities

[65] See Drago, *supra* note 16, at 118-19, 126-35.

[66] See STREET, *op. cit. supra* note 40, at 19-24; Friedmann & Huffnagel, *supra* note 16, at 144-45, 150-52; Muggia, *supra* note 16, at 243, 244-47, 262-64; Braband, *Liability in Tort of the Government and Its Employees: A Comparative Analysis with Emphasis on German Law*, 33 N.Y.U.L. REV. 18 (1958).

[67] See Irizarry y Puente, *The Responsibility of the State as a "Juristic Person" in Latin America*, 18 TUL. L. REV. 408, 421-22 (1944).

from the jurisdiction of its own courts."[68] It appears, however, that the preferred procedure for complaints against government bureaus for allegedly illegal acts is through administrative channels.[69] The complainant may address himself directly to the head of the office responsible for the act; or he may proceed through the Office of the Prokuror, a sort of public prosecutor, through a State Control Office, or through Communist Party channels. An elaborate procedure exists for the investigation and disposition of cases, with the possibility of appeal to the higher administrative officers. The surveillance of administrative acts to assure their legality and to protect the citizen against bureaucratic encroachment upon his rights is a particular responsibility of the Prokuror's office. The economic instrumentalities of the state, the public corporations, are, however, subject to suit with little restriction.[70] An individual complainant may take his case to the ordinary courts. In a case involving two public corporations, however, the proper state arbitration tribunal has jurisdiction. Soviet law permits foreign corporations that have been licensed to do business in the country to have access to the courts upon the same terms as Soviet citizens. Foreign corporations that are not licensed are permitted to sue in Soviet courts defendants who are resident within Soviet territory, provided the country of which the plaintiff is a national accords reciprocity.[71] In practice, however, disputes between foreign corporations and Soviet entities are more usually settled by arbitration, as provided by contract or by international agreement.[72]

IV

QUALIFIED IMMUNITY

By the early nineteenth century, the principle had become well established that the foreign state, when its interest became involved beyond its boundaries, was immune, unless it chose to waive its immunity, from the jurisdiction of the courts of the territorial sovereign, except with respect to matters concerning real property within the territories of the latter, other than property for diplomatic establishments, and with respect to succession. That principle was widely regarded as a rule of international law. Within the last century, however, there has been recorded very considerable progress away from that simple formula—progress that a stark realist, focusing on world-wide conditions, might feel inclined to describe as largely in the direction of chaos.

In the last quarter of last century, the courts of certain civil-law countries, led by those of Belgium and Italy, began to break away from the doctrine of absolute immunity. Following the principles of their domestic law, the judges and the doctrinal writers postulated a duality within the state which enabled them to undertake

[68] Pisar, *Soviet Conflict of Laws in International Commercial Transactions*, 70 HARV. L. REV. 593, 649 (1957).
[69] See Nove, *Some Aspects of Soviet Constitutional Theory*, 12 MODERN L. REV. 12, 34-36 (1949).
[70] See Hazard, *supra* note 17, at 391-93.
[71] See Pisar, *supra* note 68, at 605-06.
[72] See *id*. at 606-13.

to distinguish between the foreign sovereign's acts of public authority or sovereign functions, and his acts of a private character. With respect to the former, he retained his immunity; with respect to the latter, he was held to be properly subject to suit before the local courts in the same way as a private citizen. The acceptance of this theory was hastened and widened by developments of the last forty years: the monopolization of industry by, and the extension of the state-trading activities of, the Soviet state; the nationalization of substantial segments of industry in other countries; and the growing consciousness throughout the world of the need for more careful regard for and extension of "the rule of law." Decisions have been rendered in accordance with the restrictive theory in many Continental European countries, in Egypt, and in several countries in Latin America. The United Kingdom and the other members of the British Commonwealth, the United States, the Soviet Union, and the satellite countries are usually classified as supporters of absolute immunity,[73] although the United States Department of State has recently veered from that doctrine, and strong criticism of it is being heard in Great Britain. In consequence of these developments, it would appear that it can no longer be maintained that there is any requirement of international law that a foreign state be exempted from court jurisdiction.[74]

The immunity of the property of the foreign state from execution is regarded as a separate matter from that of immunity of the state instrumentality from suit; and the immunity principle as concerns the former has, to date, enjoyed the greater degree of respect. Even in the countries where the doctrine of limited immunity prevails as to suit, the foreign sovereign's property is more usually held secure from attachment or sequestration. Two explanations may be given as to why this is so: since the territorial sovereign, under the most liberal responsibility laws, remains exempt from execution, the foreign sovereign should not be less favored; and interference with the foreign sovereign's property is likely to entail a threat to peaceful international relations. But there are indications that this part of the absolute immunity doctrine, too, is beginning to weaken. There have been a number of cases in the countries adhering to the restrictive theory where the courts have shown a disposition to order execution upon state property, although, as yet, a clear-cut rule has not been established.[75] Liberally inclined doctrinal writers have not hesitated

[73] The assignment of countries to the absolute or restrictive theory groups may depend upon the particular court decisions the assigner considers determinative. In a number of countries, the situation is unclear. The latest extensive survey appears to be that by Lauterpacht, *The Problem of Jurisdictional Immunities of Foreign States*, 28 BRIT. YB. INT'L L. 220, 250-92 (1951). See also the State Department letter to Department of Justice, the so-called Tate Letter, 26 DEP'T STATE BULL. 984 (1952), and the statement of George S. Leonard, Department of Justice, minimizing the extent of acceptance of the restrictive theory, *The United States As Litigant in Foreign Courts*, in AM. SOC'Y INT'L L. PROC. 95 (1958).

[74] See Fitzmaurice, *State Immunity from Proceedings in Foreign Courts*, 14 BRIT. YB. INT'L L. 99, 117-18 (1933); Lauterpacht, *supra* note 73, at 226-32; Lalive, *L'immunité de jurisdiction des États et des Organisations internationales*, in 3 HAGUE ACADEMY OF INTERNATIONAL LAW, RECUEIL DES COURS 205, 251-52 (1953).

[75] See Lalive, *supra* note 74, at 275-78; Lauterpacht, *supra* note 73, at 241-43.

to advocate restriction upon the privileges of the state as to execution upon its property.[76]

Although the doctrine based upon a distinction between the public and the private acts of the state has provided the means for an extensive breach in the bulwarks of sovereign immunity, the doctrine itself contains recognized weaknesses that have retarded its spread and are likely to prevent its universal adoption as immunity law. It assumes that the traditional functions of the state are the essentially sovereign ones, and that the newly assumed economic functions, having been taken over from the private sector, may, because of their nature, be properly assigned a different and inferior status. It neglects to recall that state monopoly of the essentially sovereign functions has not at all times and in all places been complete, and that state activities in military affairs, justice, and even public finance, for example, sometimes came to be acts of public authority in a manner not wholly lacking in similarity to that in which the state has become involved in state trading and other economic activities. In practice, the problem in applying the restrictive theory arises from the lack of satisfactory criteria for determining which acts are public acts and which are private acts.[77] Justice Van Devanter struck to the heart of the logical difficulty when he said in the *Pesaro* decision, "We know of no international usage which regards the maintenance and advancement of the economic welfare of a people in time of peace as any less a public purpose than the maintenance and training of a naval force."[78] Consequent upon this lack of criteria, the decisions of the tribunals have been conflicting not only among the different countries, but also, on occasion, within the several national jurisdictions.[79]

The apparent impossibility of formulating objective criteria for differentiating between acts of sovereignty and private acts has induced many proposals looking to the formulation of a doctrine that would provide a more positive and reliable formula for limiting the immunity of the state.[80] One approach that has received favorable attention would make the basis for according or denying immunity a determination of whether a private person could perform the act in question. A notable presentation of this approach is to be found in the "Draft Convention on Competence of

[76] See Lauterpacht, *supra* note 73, at 241-43; Lalive, *supra* note 74, at 279-80; Harvard Research in International Law, *Draft Convention on Competence of Courts in Regard to Foreign States*, 26 AM. J. INT'L L. 455, 706 *et seq.* (Supp. 1932).

[77] Professor Friedmann, however, sees no greater difficulty for the courts in establishing acceptable criteria in this matter than, for example, in determining what is "reasonable," as they so often have to do in the common-law countries. Friedmann, *Some Impacts of Social Organization on International Law*, 50 AM. J. INT'L L. 475, 481 (1956).

[78] Berizzi Bros. Co. v. S.S. Pesaro, 271 U.S. 562, 574 (1926).

[79] See Lauterpacht, *supra* note 73, at 222-24, for an account of the conflicting judgments.

[80] The three proposals discussed here by no means exhaust the subject. See, *e.g.*, Hervey, *The Immunity of Foreign States When Engaged in Commercial Enterprises: A Proposed Solution*, 27 MICH. L. REV. 751 (1929), advocating a United States Act of Congress establishing jurisdiction over foreign state enterprises; PAUL SHEPARD, SOVEREIGNTY AND STATE-OWNED COMMERCIAL ENTITIES 98-100 (1951), in which the author argues that the state's engaging in commercial activities through a state-owned commercial entity should be construed as a waiver, ipso facto, of immunity; and Lalive, *supra* note 74, at 242, 257-72, 287-89, in which various reform proposals are reviewed, including suggestions for international conventions.

Courts in Regard to Foreign States" of the Harvard Research in International Law.[81] This project, formulated in 1932, would subject a foreign state to the jurisdiction of the local courts, except with respect to matters in relation to its public debt, if it should engage in an industrial, commercial, financial, or other enterprise within their jurisdiction that a private person could there engage in, or if it should perform an act within their jurisdiction in connection with such an enterprise, regardless of where established. This formulation has been criticized on the ground that it is sometimes very difficult to determine whether a specific class of act can be performed by a private person.[82] Should the purchase of a warship, for example, by a foreign state be equated with the purchase of a yacht by a private person; or should the former be regarded as an act of sovereignty entailing exemption from suit? A curious result of the practical application of the Harvard Research formula would be that instrumentalities of a predominantly private-enterprise state would be entitled to a large measure of immunity within a socialistic state, while the latter's enterprises in the former's territories would be suable like private persons.

Professor Lauterpacht has come forward with a logical and practical proposal for solution of the problem, one that should be especially attractive to those familiar with the development of domestic immunity law and procedures within the United States and the British Commonwealth.[83] Having satisfied himself that neither the absolute theory nor the restrictive theory of immunity has any foundation in international law, he concludes that a reasonable method of making the instrumentalities of the foreign state amenable to justice would be to assimilate the foreign sovereign as completely as practicable to the position of the territorial sovereign. Under such a plan, a British state instrumentality in the United States would be suable with respect to contract in the Court of Claims and in the federal district courts with respect to tort. It would be entitled to the same procedural privileges and exemptions that the law provides for the United States. Lauterpacht stipulates that there should be specified exceptions from the rule of assimilation, for which immunity should be retained: legislative acts of the foreign state; administrative and executive acts performed on its own territory; questions involving contracts that under the rules of private international law would not be within the competence of the courts concerned; questions concerning diplomatic privileges and immunities; and questions involving the seizure of a war vessel or military aircraft or the responsibility of the foreign state's armed forces.

A Swiss publicist, Jean-Flavien Lalive, in a study published in 1953, submitted a plan also designed to minimize uncertainties and to limit immunity to a few essential categories of state activities.[84] Lalive, like Lauterpacht, affirms the nonexistence of any requirement in international law for according immunity to foreign states. He has much respect, however, for the progress made by means of the doctrine distinguishing between acts of authority and private acts, and he sees a need

[81] 26 AM. J. INT'L L. 455, 597 (Supp. 1932).

[82] Lalive, *supra* note 74, at 259-60.

[83] Lauterpacht, *supra* note 73, at 236-41.

[84] Lalive, *supra* note 74, at 285-86.

for building upon the accomplishments under that doctrine without revolutionary change. His objective is to provide authoritative guidance for the courts, so as to eliminate ambiguous or deficient judgments and to assure an appropriate degree of uniformity internationally in the application of the law. He would first restate the principle so as to emphasize general absence of a right to immunity: "The foreign state enjoys jurisdictional immunity only for certain acts of public authority." He would have this restatement accompanied by a limitative list of categories of acts of public authority for which immunity should be accorded, and the courts might add to or subtract from the list as experience might indicate the desirability. His list includes: internal administrative acts of the foreign state (*e.g.*, expulsion of an alien); legislative acts (*e.g.*, a nationalization law); acts concerning the armed forces; acts relating to diplomatic activities; and questions concerning public loans contracted abroad by the foreign state. It is Lalive's intent that in cases not covered by the list of exceptions, the state should be subject to local jurisdiction in the same way as private persons; he does not take into consideration, as Lauterpacht does, the intermediate stage represented by the "consent" legislation of the United States and the countries of the British Commonwealth.

The proponents of the reform projects described above vary somewhat as to the methods recommended for making their schemes effective. The Harvard Research project is in the form of a draft international multilateral convention. Lauterpacht suggests that his scheme of assimilation could be carried out by unilateral legislation or by international agreement, but his greatest hopes apparently lie in the direction of reform through the codification efforts of the International Law Commission of the United Nations.[85] Lalive fears that an attempt at a multilateral convention would be frustrating, because of the tendency to achieve only a least-common-denominator level. He thinks that legislative or executive regulation on a unilateral basis would contribute to progress, though perhaps in a fragmentary manner, and that bilateral treaties would provide a very efficacious method. He concludes that the most desirable results, however, could be obtained through the establishment of a system of international courts, with jurisdiction over cases involving the liability of foreign states.[86]

Space and the plan of this discussion preclude any attempt to survey developments in this field on a country-by-country basis, but reference to and comment upon recent developments in the United States appear apposite. This country's historic adherence to the rule of absolute immunity, pursuant to Marshall's decision in *The Schooner Exchange v. McFaddon*,[87] has been mitigated by recourse to certain important exceptions that may, on occasion, result in bringing foreign state-trading enterprises to respond in justice. The most important of these applies to corporate entities owned or controlled by a foreign state. Relying upon another of Marshall's

[85] Lauterpacht, *supra* note 73, at 247-50.
[86] Lalive, *supra* note 74, at 287-90.
[87] 11 U.S. (7 Cranch)* 116 (1812).

opinions, *Bank of the United States v. Planters Bank*,[88] the courts have tended to deny immunity to such corporations, except in certain cases where they have chosen to conclude that the entity was, in fact, an arm of the foreign government. Another basis for exception from immunity has been a finding that a merchant vessel, for example, though owned by a foreign government, was not in possession of that government at the time of the cause of action.[89]

Following World War I, after which some of the war-spawned state entities continued to engage in economic activities in competition with private enterprise, and the state-trading programs of the Soviet Union became a cause of concern, a steady succession of professional writings appeared in periodical and book form criticizing the principle of absolute immunity and recommending reform. No American defenses of the old order of any consequence have appeared in print.[90] Prior to 1926, the Department of State, in a number of instances, took the position that foreign states should not be entitled to immunity for their commercial activities.[91] In that year, however, in the *Pesaro* case, the Supreme Court disregarded the views of the Department and accorded immunity to a merchant vessel owned and operated by the Italian Government. Thereafter, the Department abandoned its efforts to limit the immunity of foreign states and did not resume them until after World War II.

The group of United States commercial treaties containing an immunity waiver has previously been referred to.[92] This waiver provision was not designed, however, to establish a general policy with respect to immunities of foreign states for the United States. The policy it represents was initiated in 1949, at a time when treaties were contemplated with a number of countries that were in the process of nationalizing large segments of their industries. The basic purpose of the treaties was to facilitate the admission of United States private enterprises into foreign countries in connection with programs for their economic development; but, of necessity, equal rights were stipulated for foreign enterprises to establish themselves in the United States. It was anticipated that the nationalization of enterprises that had branches or subsidiaries in this country and the expected efforts of certain state-owned industries to seek to set up establishments here would give rise to problems of adjustment to the American private-enterprise system. Hence, the inclusion of clauses to assure that such state-owned enterprises as might be entitled to treaty rights would not

[88] 22 U.S. (9 Wheat.)* 904, 907-08 (1824). This case, of course, did not involve a foreign state, but one of the states of the United States.

[89] See Fensterwald, *Sovereign Immunity and Soviet State Trading*, 63 HARV. L. REV. 614, 619-20 (1950).

[90] For a list of the principal authors and their writings, see Bishop, *New United States Policy Limiting Sovereign Immunity*, 47 AM. J. INT'L L. 93, 96 n. 13 (1953).

[91] 2 HACKWORTH, *op. cit. supra* note 20, at 429, 437, 438-41.

[92] See text at note 27 *supra*. A total of fourteen treaties containing the waiver were negotiated, of which those with the following countries have entered into force: Italy, Ireland, Greece, Israel, Japan, Federal Republic of Germany, Iran, Nicaragua, the Netherlands, and Korea. A typical waiver provision appears in Treaty of Friendship, Commerce, and Navigation With the Federal Republic of Germany, Oct. 29, 1954, art. XVIII, para. 2, [1956] 7 U.S.T. & O.I.A. 1839, T.I.A.S. No. 3593 (effective July 14, 1956).

evade the liabilities to which private enterprises in competition with them were subject.

The waiver extends not only to immunity from suit, but also to immunity from execution of judgment, from taxation, and from any other liability to which private enterprise is subject. The waiver provisions were drafted in language which, when considered in the context of other establishment provisions, limits the effect to the sort of establishment situations here referred to. Although the waiver is expressed in reciprocal terms, it could have a bearing upon United States rights to immunity abroad only if this country should undertake to establish public enterprises, such as factories, department stores, or insurance companies, in countries with which the treaties are in effect. The limited restrictive policy of the treaties is comparable to that enforced administratively by the Civil Aeronautics Board when it makes a waiver of immunity a requirement for the issuance of a permit to a foreign air carrier.[93]

The most noted event in regard to the subject of sovereign immunity that has occurred within recent years was the public announcement in 1952 by the Department of State that thenceforward, with respect to its own action regarding requests from foreign governments for a grant of immunity from suit, it would follow the restrictive theory.[94] The action referred to is the furnishing to the court, usually upon request of the foreign government concerned, of the Department's "suggestion and certificate" favoring the granting of immunity in the specific case, or the refusal to recommend immunity. This procedure has developed from the long-standing tendency of the courts to assign great weight to the views of the executive branch in a matter considered to be of importance in the conduct of foreign relations. In fact, in decisions handed down in the 1940's, the Supreme Court seemed to take the position that the determination by the Department of State is binding upon the courts.[95]

In its announcement, the Department endorsed in a forthright manner the Continental European concept of the responsibility of the state under which "the immunity of the sovereign is recognized with regard to sovereign or public acts (*jure imperii*) of a state, but not with respect to private acts (*jure gestionis*)," disregarding the serious criticism a number of leading commentators have directed at that concept.[96] The policy set forth—and, indeed, prior United States practice in the premises—placed the responsibility upon the Department for determining whether a given act of the foreign state were of the essence of sovereignty, or a mere private act, a

[93] The authority for this is 52 STAT. 991 (1938), as amended, 49 U.S.C. § 482 (1952).

[94] The announcement is in the form of a letter from the Department's Acting Legal Adviser, Jack B. Tate, to the Acting Attorney General, Philip B. Perlman, dated May 19, 1952. 26 DEP'T STATE BULL. 984 (1952). The background and implications as envisaged at the time are authoritatively presented in Bishop, *New United States Policy Limiting Sovereign Immunity*, 47 AM. J. INT'L L. 93 (1953).

[95] *Ex Parte* Republic of Peru, 318 U.S. 578, 587-89 (1943); Republic of Mexico v. Hoffman, 324 U.S. 30, 35-36 (1945). See also Lyons, *The Conclusiveness of the "Suggestion" and Certificate of the American State Department*, 24 BRIT. YB. INT'L L. 116 (1947).

[96] See text at notes 80-86 *supra*.

responsibility widely held to be properly a judicial function.[97] A reason given for the change in policy was that "the Department feels that the widespread and increasing practice on the part of governments of engaging in commercial activities makes necessary a practice which will enable persons doing business with them to have their rights determined in the courts." The announcement was generally received as a highly desirable progressive step, definitely aligning the United States with the practitioners of the restrictive theory.[98]

What the ultimate effect of the 1952 declaration will be upon United States policy in actual practice remains to be seen. Since its issuance, no really significant case has arisen to test the determination of the Government to be guided by the principles set forth, to indicate the criteria by which a determination is to be made as to what classes of acts are entitled to immunity, and to establish the firm precedent needed to fix the lines of a permanent policy. In the meantime, moreover, the kinds of perplexities and conflicting points of view that have always vexed reform attempts in the field of state immunities have begun to crop up. Any significant change in the policy applicable in the case of foreign state instrumentalities in the United States may be expected to have the potential, at least, of influencing the treatment of activities of the United States in foreign jurisdictions; and, at the present time, there is a vast preponderance of American governmental activities abroad that could perhaps be brought under the jurisdiction of foreign courts, over foreign state activities within the possible jurisdiction of the United States. Officials of the Department of Justice, charged with the onerous responsibility of defending the United States against claims arising abroad, prefer the effective and inexpensive defense of meeting nearly every proceeding with the plea that it is an unconsented suit against a sovereign. Weighty practical difficulties would be encountered, of course, in submitting United States governmental instrumentalities generally to the jurisdiction of foreign courts, one of the most embarrassing of which is lack of appropriations to cover payment of costs and judgments against the United States, unless Congress should decide to make provision therefor.

The Department of Justice position leans very heavily, therefore, to the side of the theory of absolute immunity for the foreign state.[99] Faced with the pronounced general sentiment of the leaders of the legal profession in favor of the "rule of

[97] For critical comments upon the tendency of the executive branch to assume judicial functions in this subject matter, see Jessup, *Has the Supreme Court Abdicated One of Its Functions?* 40 AM. J. INT'L L. 168 (1946); Note, *Judicial Deference to the State Department on International Legal Issues*, 97 U. PA. L. REV. 79 (1948); Cardozo, *Sovereign Immunity: The Plaintiff Deserves a Day in Court*, 67 HARV. L. REV. 608 (1954).

[98] Bishop, *New United States Policy Limiting Sovereign Immunity*, 47 AM. J. INT'L L. 93 (1953); Lalive, *supra* note 74, at 234-35; Cardozo, *supra* note 97; Brandon, *Sovereign Immunity of Government-owned Corporations and Ships*, 30 CORNELL L.Q. 42, 442-45 (1954); Reeves, *Leviathan Bound—Sovereign Immunity in a Modern World*, 43 VA. L. REV. 529, 554 (1957).

[99] The Department of Justice position is most fully set forth by George S. Leonard, of that Department's Civil Division, *supra* note 73. The resurgence of absolute immunity doctrine within the Government is also indicated by developments in connection with the consideration of a proposed resolution on sovereign immunity at the 1958 Conference of the International Bar Association. A draft resolution borrowing much from the highly respected Harvard Research Draft Convention had been prepared by a committee, see Reeves, *Good Fences and Good Neighbors: Restraints on Immunity of Sovereigns*, 44

law," to which both the present attorney general and his predecessor have lent public support, its officials have, however, proposed an approach of a sort to a limitation of foreign state immunities. They suggest an arrangement by treaty under which, on a reciprocal basis, the liabilities that each nation has assumed under its own law would be enforceable against it by foreign courts.[100] Under such arrangement, for example, French courts would apply the Tucker Act, Federal Tort Claims Act, and other American legislation against the United States, while United States federal and state courts would apply French administrative law in suits against France. Apparently, the principal merit claimed for this proposal is that it would not increase the liabilities of any state above those it had accepted domestically, but would provide a litigant with a forum within his own country. Also, it would have the effect of keeping each country's liabilities uniform throughout the world, rather than allowing them to vary according to each country's laws. It would appear to be open to criticism, however, as a proposal for the extraterritorial extension of national laws, and would doubtless give rise to various sorts of procedural problems, as well as the usual difficulties accompanying attempts to interpret and enforce foreign law.

CONCLUSION

Although advocates of the limitation of state immunities have indicated concern lest these special privileges in the hands of instrumentalities engaged in economic activities endanger private enterprise and hinder the development of trade, the published materials available do not provide a factual basis for a conclusion that immunities per se constitute at the present time any grave or imminent danger. This is not to say, of course, that immunities are not deserving of special attention with a view to proper reform, or that the critical commentators have not helped to prevent them from becoming a more serious problem.

For a meaningful evaluation of the immunities of the state, as concerns their actual and potential effect upon economic affairs, studies quite different from any so far published are needed. Court decisions and records constitute a valuable source of information, but analysis needs to go farther than that of the legal investigator concerned principally with what the law is or ought to be. They need to be studied for the light they may throw upon the nature, seriousness, and dimensions of the problems arising from state immunities. Consultation with officials of private concerns as to their experience with immunities and some investigation in private business records might also be revealing. Analysis of actual business relationships between typical state instrumentalities and private enterprises should indicate the extent that immunity problems are of significance in such relationships. The ad-

A.B.A.J. 522 (1958), and was scheduled for adoption by the Conference. Because of the intervention of several high ranking federal officials, who took the position that such resolutions might make it more difficult for the United States to maintain its immunity from suit in foreign courts, American representatives at the Conference opposed the resolution and succeeded in having it deferred for further study and possible revision. See Anderson, *The International Bar Association Conference at Cologne, Germany*, 5 FED. B. NEWS 312 (1958).

[100] See Leonard, *supra* note 73, at 103; Brownell, *Lawyers and a Government of Law*, 13 RECORD OF N.Y.C.B.A. 188, 201 (1958).

ministrative and legislative settlement of claims and the utilization of commercial arbitration procedures in settlements would have to be studied as essential parts of the picture. Even on the purely legal side, there are wide gaps in the accounts regarding jurisdictional immunities in many countries and generally with respect to exemptions from taxation and statutory regulation. Extensive research of such difficulty on this subject will probably not be considered justified, but until more realistic data are available, judgments on the economic implications of state immunities can represent little more than speculation.

On the basis of his exhaustive study of governmental tort liability in the United States, Professor Davis concluded that "of all deserving tort claims against federal, state and local governmental units, probably far more are paid today than are unpaid. . . ."[101] Probably one can do little better by way of describing the world-wide situation with respect to claims in general against governments than to adapt that statement accordingly. Defeats of justice unquestionably occur in business dealings between private and public enterprises, and state immunities are sometimes to blame. But defeats of justice also occur in business relations between private persons, and free access to courts is not always a complete solution. It seems a fair presumption that the business morality of governmental units averages higher than that in the private sector, and such a probability in itself might be thought to justify a special legal status for state instrumentalities. In any case, there appears to be no lack of a readiness on the part of private enterprise generally to deal with governments, and there are sometimes observable indications of a preference for dealing with them. Other deficiencies in the administration of justice, including such shortcomings as lack of trained judges, crowded dockets, unreasonable delays, and dishonesty of officials, are, on a world-wide basis, probably a far more serious handicap to free economic enterprise than results from state immunities. There is another side to the coin also. If state liabilities should be expanded indefinitely along such lines as indicated by certain decisions in France,[102] for example, the monetary cost to private enterprise, by way of taxation, might be far more serious than the injuries resulting from the remaining vestiges of sovereign immunity. On the international side, especially troublesome problems may arise from claims of immunity for the state trading agencies of the Soviet Union and the satellites. Four decades of experience seem to have demonstrated, however, that state immunities do not constitute one of the major difficulties in the way of East-West trade, and that other problems solved, bargaining at the government level can produce a reasonable degree of protection for the private interests involved.

[101] Davis, *supra* note 42, at 751.

[102] In the *Fleurette* case, adjudicated by the Council of State in 1938, damages were awarded against the state when a manufacturer of cream substitutes was forced out of business by legislation, enacted at the behest of the dairy industry, forbidding manufacture and sale of such substitutes. La Fleurette, Conseil d'État, Jan. 14, 1938, [1938] Recueil des arrets du Conseil d'État 25, [1938] S. III.25 (Fr.). In a similar case, decided in 1944, a sugar manufacturer was indemnified for loss resulting from a law, enacted to favor cereal producers, reducing the amount of sugar that might be used in brewing beer. See Davis, *supra* note 42, at 792-93; Jacoby, *supra* note 60, at 258.

ARBITRATION OF STATE-TRADING RELATIONS

MARTIN DOMKE*

State-trading operations, it is widely felt including those not completely motivated by economic considerations, should conform to world trade customs, at least in so far as the disposition of controversies is concerned.[1] A reflection of this attitude can be found in the modern commercial treaties of the United States, which expressly disavow immunity in state-trading relations with respect not only to "suits"[2] in ordinary courts, but also to arbitration.[3] Thus, too, recent resolutions of the Inter-American Bar Association,[4] the International Law Association,[5] and the International Chamber of Commerce[6] have recommended the use of arbitration for the settlement of disputes

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[1] See *e.g.*, Seidl-Hohenveldern, *Commercial Arbitration and State Immunity,* in MARTIN DOMKE (ED.), INTERNATIONAL TRADE ARBITRATION: A ROAD TO WORLD-WIDE COOPERATION 87 (1958); Schmitthoff, *The Claim of Sovereign Immunity in the Laws of International Trade,* 7 INT'L & COM. L. Q. 452 (1958); Macdonald, *New Method to Test Sovereign Immunity from Suit,* 36 CAN. B. REV. 549 (1958). A searching discussion of the manner in and extent to which immunity from foreign jurisdiction is invoked for state-trading operations appears elsewhere in this symposium. See Setser, *Sovereign Immunity and State Trading, supra* 291.

[2] See, *e.g.*, Treaty of Friendship, Commerce, and Navigation With the Republic of Korea, Nov. 28, 1956, T.I.A.S. No. 3947 (effective Nov. 7, 1957): "No enterprise of either Party, including corporations, associations, and government agencies and instrumentalities, which is publicly owned or controlled shall, if it engages in commercial, industrial, shipping or other business activities within the territories of the other Party, claim or enjoy, either for itself or for its property, immunity therein from taxation, *suit, execution of judgment* or other liability to which privately owned or controlled enterprises are subject therein." (Emphasis added.)

[3] *Cf.* Madawick Contracting Co., Inc. v. Travelers Ins. Co., 307 N.Y. 111, 119, 120 N.E.2d 520, 523 (1955), where it was said: "'Judgment' shall include such judgments as are entered upon confirmation of arbitration awards. . . ."

[4] "That the machinery of commercial arbitration within the Western Hemisphere should also be used for disputes between individuals and foreign governments in matters in which those governments participate directly or through their agencies and corporations in international trade." INTER-AMERICAN BAR ASS'N, PROCEEDINGS 269 (1952).

[5] "The International Law Association recommends the intensive development and use of international commercial arbitration for the settlement of disputes including those between Governments and agencies and Government-controlled corporations and private persons of different countries." INT'L LAW ASS'N, REPORT OF THE FORTY-FOURTH CONFERENCE 264 (1950).

[6] "The International Chamber of Commerce recommends governments, governmental agencies and government-controlled corporations to insert in their contracts with private individuals and firms of another country an arbitration clause providing for the settlement of possible disputes by recourse to existing organizations of international commercial arbitration." INT'L CHAMBER OF COMMERCE, RESOLUTIONS OF THE XIV CONGRESS 91 (Brochure No. 175, 1953). Arbitration between states and private firms was also discussed at the XVII Congress of the International Chamber of Commerce, Washington, D.C., April 21, 1959.

arising out of contracts to which governments or their agencies are parties.[7]

When foreign states or state-owned or controlled companies have concluded arrangements with American traders,[8] especially in wartime dealings[9] or in the post-war period of economic reconstruction,[10] they have customarily submitted their disputes to private arbitration under the rules of the American Arbitration Association. Only once, in 1946, has the issue of sovereign immunity in arbitration been raised in this country; and even then, it was not pursued to a final determination.[11] Contracts between the United Nations and its agencies and private firms have likewise provided for dispute-settlement under the rules of private arbitration organizations;[12] and in some instances, arbitration proceedings have been utilized.[13] Among the foreign governmental agencies which have submitted controversies to private arbitration have been the Argentine Institute of Trade Development,[14] the Turkish Railway Administration,[15] and a nationalized Czechoslovakian enterprise, formerly Dynamit Nobel, now Georges Dimitrov.[16] The elaborate private arbitration set-up

[7] The Commission on International Commercial Arbitration of the International Chamber of Commerce, the Ad-hoc Working Group on Arbitration of the Committee on the Development of Trade of the Economic Commission for Europe, see *infra* note 22, and the Committee on International Commercial Arbitration of the International Law Association are actually engaged in detailed studies of the problems of arbitration between governments and foreign traders. The International Institute for the Unification of Private Law in Rome, too, has established a working committee on arbitration between governments and individuals. A draft convention prepared by its chairman, Judge Algot Bagge, of Sweden, considers the possibility of conferring on the Permanent Court of Arbitration at the Hague such jurisdiction, through an agreement between states and an amendment of the Court's statute. See 3 INT'L INST. FOR THE UNIFICATION OF PRIVATE LAW, UNIFICATION OF LAW 65 (1954). This effort, however, is a general one, not specifically concerned with state-trading relations.

[8] Where the state, as such, is not party to the arrangement, it may be noted, "adequate opportunity for consultation" in trade controversies is, nevertheless, provided in the General Agreement on Tariffs and Trade, Oct. 30, 1947, 61 STAT. (5), (6), T.I.A.S. No. 1700, art. XXII (effective Jan. 1, 1948). See also Economic Agreement of Bogota of May 2, 1948, art. 38, and the Rules of Procedure to Facilitate the Peaceful and Rapid Settlement of Economic Disputes, adopted by the Council of the League of Nations, Jan. 28, 1932, all pertinent provisions of which may be found in U.N. Doc. No. E/ECE/270, pt. II, at 1-5 (1957).

[9] See, *e.g.*, Government of the Kingdom of The Netherlands v. American Armament Corp., 58 N.Y.S.2d 300 (Sup. Ct. 1945).

[10] See, *e.g.*, Republic of France v. Ingalls Shipbuilding Corp., Civil No. 5986, N.D. Ala., March 31, 1947, noted in 2 ARB. J. (n.s.) 264 (1947); République Française v. Cellosilk Mfg. Co., 309 N.Y. 269, 128 N.E.2d 750 (1955); American Rail and Steel Co. v. India Supply Mission (Government of India), 308 N.Y. 577, 127 N.E.2d 562 (1955), noted in 13 ARB. J. (n.s.) 33 (1958); Government of the Argentine Republic v. Gaylen Machinery Corp., 10 Misc.2d 215, 169 N.Y.S.2d 978 (Sup. Ct. 1957).

[11] In Peter B. Payne, Inc. v. National Resources Commission of China, the defendant appeared specially in the Supreme Court of New York, County of New York, and moved to vacate a warrant of attachment, obtained under a contract for engineering services containing an arbitration clause, on grounds of sovereign immunity. N.Y.L.J., Aug. 23, 1946, p. 321; *id.*, Aug. 30, 1946, p. 361. *Cf.* Duff Development Co., Ltd. v. Government of Kalatan, [1924] A.C. 797.

[12] See 5 REPERTORY OF PRACTICE OF UNITED NATIONS ORGANS 332 (1955).

[13] *E.g.*, by the United Nations Children's Fund, and the United Nations Korean Reconstruction Agency, under the rules of the American Arbitration Association.

[14] Referring to the rules of the Inter-American Commercial Arbitration Commission.

[15] See Turkish State Railways Administration v. Vulcan Iron Works, 136 F. Supp. 622 (M.D. Pa. 1955), *appeal dismissed* (as from an interlocutory decision denying a motion to compel arbitration), 230 F.2d 108 (3d Cir. 1956). See also Turkish State Railways Administration v. Vulcan Iron Works, 153 F. Supp. 616 (M.D. Pa. 1957).

[16] Under the Rules of Conciliation and Arbitration of the International Chamber of Commerce. *Cf.*

under both the so-called International Consortium Agreement of the National Iranian Oil Company of September 1954[17] and the agreement of September 5, 1957 of the same Iranian governmental agency with A.G.I.P. Mineraria, an Italian subsidiary of Ente Nazionale Idrocarbari,[18] should also be noted.

Of much greater importance, however, is the settlement by arbitration of trade disputes between the traders of planned and free economies. In this connection, it is significant that the Soviet Union's recent proposal for an All-European Agreement on Economic Cooperation would provide in article nine:[19]

> The participating States undertake to give effect to arbitral decisions in disputes arising out of commercial contracts concluded by their citizens, organizations, or institutions, where provision is made in the contract itself, or in a separate agreement expressed in the form required by the contract that disputes shall be settled by a specially or permanently constituted arbitration tribunal.[20]

Various countries, however, have considered this provision unnecessary,[21] in as much as the Economic Commission for Europe had already studied the question of arbitration, particularly with respect to state-trading instrumentalities.[22] Furthermore, the United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards, concluded on June 10, 1958,[23] with the participation of several planned-economy countries,[24] expressly provides that the Convention applies not only to awards rendered by *ad hoc* appointed arbitrators, but also to "those made by permanent arbitral bodies."[25]

The General Conditions of Delivery of Goods between Foreign Trade Organizations of Member Countries of the Council for Mutual Economic Aid,[26] in force since January 1, 1958, also provides for arbitration[27] of all controversies arising out of or in

Société Kohorn v. Société Dimitrov, Trib. civ. Seine, Oct. 17, 1956, [1956] Juris Classeur Periodique 9647 (note Motulsky) (Fr.).

[17] Art. 40-45, the text of which appears in *Hearings Before the Antitrust Subcommittee of the House Committee on the Judiciary,* 84th Cong., 1st Sess. ser. 3, pt. 2, at 1563 (1955).

[18] See Wall, *The Iranian-Italian Oil Agreement of 1957,* 7 INT'L & COMP. L.Q. 736, 750 (1958).

[19] U.N. Doc. No. E/ECE/270, pt. I, at 9 (1957).

[20] *Cf.* the recent Afro-Asian Conference in Cairo, which decided to set up a permanent Afro-Asian Economic Co-operation Organization. See Journal of Commerce (N.Y.), Dec. 12, 1958, p. 22, col. 4.

[21] Austria, Belgium, Denmark, France, Italy, Luxembourg, Norway, Portugal, Sweden, and the United Kingdom. See U.N. Doc. No. E/ECE/270, pt. I, at 14, 15, 22, 29, 36, 43, 46, 52, 57; *id.*, pt. II, at 11 (1957).

[22] By the Ad-hoc Working Group on Arbitration of its Committee on the Development of Trade. See Benjamin, *The Work of the Economic Commission for Europe in the Field of International Commercial Arbitration,* 7 INT'L & COMP. L. Q. 22 (1958).

[23] U.N. Doc. No. E/Conf. 26/9 Rev. 1 (1958). See Domke, *The U.N. Conference on International Commercial Arbitration,* 53 AM. J. INT'L L. 414 (1959).

[24] Albania, Bulgaria, the Byelorussian Soviet Socialist Republic, Czechoslovakia, Poland, the Ukranian Soviet Socialist Republic, the Union of Soviet Socialist Republics, and Yugoslavia.

[25] For more extended discussion, see text accompanying notes 81-88 *infra.*

[26] The Council was established in January 1949, as a counterpart to the Marshall Plan. Its present members are the Soviet Union, Poland, Czechoslovakia, Hungary, Rumania, Bulgaria, Albania, and the German Democratic Republic.

[27] See Berman, *Unification of Contract Clauses in Trade Between Member-Countries of the Council for Mutual Economic Aid,* 7 INT'L & COMP. L. Q. 659, 664 (1958).

connection with the contract, excluding "general courts," and specifying that such arbitration shall be held before the arbitration tribunal of the defendant, unless the parties agree to submit to arbitration by the tribunal of a third member-country of the Council for Mutual Economic Aid.[28]

Another illustration of the importance that commercial arbitration has assumed in trade between planned and free economies is the fact that a recent colloquium of lawyers, held in Rome, under the auspices of the International Association of Legal Science of UNESCO, on the Legal Aspects of Trade between Countries of Planned and Free Economies,[29] also dealt with the subject.[30] Among other basic problems, Western lawyers adverted to the pressure exerted by administrative authorities in countries with planned economies to compel arbitration in their own countries, thereby excluding a wider choice of available arbitration facilities, and the exclusion of foreign arbitrators from the arbitration panels in those countries.[31]

Clearly to understand the approach of state-trading economies to commercial arbitration, reference must be made to their historical development.[32] In the twenties, the Soviet Union was the outstanding state-trading prototype. Consistent with its economic policy during that period, the Soviet Union was eager both to obtain and to grant terms and conditions favorable to all parties. It reinforced this approach with a variety of commercial treaty arrangements with European countries to ensure that any controversy would be settled in a manner consistent with Western expectations.[33]

[28] Art. 65 reads: "All disputes which may arise out of or in connection with the contract shall be subject to consideration by arbitration, the jurisdiction of general courts being excluded, in an arbitral tribunal established for such disputes in the country of the defendant or, by agreement of the parties, in a third member-country of the Council for Mutual Economic Aid.

"Counter-claims shall be subject to consideration in the arbitral tribunal in which the original suit is considered.

"Disputes shall be considered in accordance with the rules of procedure which are operative in the arbitral tribunal in which the case is decided.

"The decisions of the arbitral tribunal shall be final and binding on the parties."

[29] See Hazard, *Commercial Discrimination and International Law*, 52 AM. J. INT'L L. 495 (1958); Graveson, *Rome Conference on International and Comparative Law*, 7 INT'L & COMP. L. Q. 585 (1958); Tunc, *Le Colloque sur les aspects juridiques du commerce entre les pays d'économie libre*, 10 REVUE INTERNATIONALE DE DROIT COMPARÉ 365 (1958).

[30] On the basis of reports by Paul L. van Reepinghen, of Belgium, Aleksander Goldstajn, of Yugoslavia, see *infra* note 48, and a memorandum by Samuel Pisar, of UNESCO. See also, Tunc, *supra* note 29, at 371; and notes by Schmitthoff, *Rome Conference on International and Comparative Law, III Colloquium on Legal Aspects of Trade Between Countries of Planned and of Free Economies*, 7 INT'L & COMP. L. Q. 588, 591 (1958), and *A New Approach to East-West Trade*, 1958 J. BUS. L. 141, 146.

[31] Attention was also directed to the matter of the law properly applicable in arbitration proceedings. *Cf.* Mezger, *The Arbitrator and Private International Law*, in MARTIN DOMKE (ED.), INTERNATIONAL TRADE ARBITRATION: A ROAD TO WORLD-WIDE COOPERATION 229 (1958).

[32] See Fensterwald, *The Effect of State Trading Upon Arbitration*, 5 ARB. J. (n.s.) 163 (1950); Hazard, *State Trading and Arbitration*, in MARTIN DOMKE (ED.), INTERNATIONAL TRADE ARBITRATION: A ROAD TO WORLD-WIDE COOPERATION 93 (1958).

[33] See Hilton, *Commercial Arbitration in the Treaties and Agreements of the U.S.S.R.*, 12 DEP'T STATE BULL. 890 (1945); and SECRETARIAT OF THE UNITED NATIONS, *Commercial Agreements*, in MEMORANDUM ON THE SOVIET DOCTRINE AND PRACTICE WITH RESPECT TO ARBITRAL PROCEDURE 15 (Doc. No. A/CN.4/36) (1950).

But the strengthening of its economy led the Soviet Union to the establishment of its own foreign trade arbitration body in Moscow—namely, the Foreign Trade Arbitration Commission[34]—whose rules of procedure were promulgated in 1932.[35] These rules have not undergone any basic change, for they are consistent with the "gradual domestication of foreign trade adjudication."[36] However, arbitration in Moscow, as is generally insisted upon by Soviet organizations, does not appear to be a *sine qua non* of foreign trade arrangements. On the contrary, commercial treaties of the Soviet Union with Denmark, of August 17, 1946,[37] and with Hungary, of July 15, 1947,[38] provide for the settlement of disputes by arbitration,[39] but not exclusively in Moscow. And as far as American business dealings with the Soviet Union are concerned, it may be significant that as recently as 1958, an American firm was able to obtain, in a contract for the establishment of a textile plant in the Soviet Union, the insertion of an arbitration clause fixing Stockholm, Sweden, as the place of arbitration.[40]

This seemingly accommodating Soviet attitude deserves rather critical scrutiny, however, in light of the recent Israeli-Soviet oil arbitration, which was received quite

[34] After a statute for a Maritime Arbitration Commission of the All-Union Chamber of Commerce was approved on Dec. 15, 1930. [1930] Sobranie Zakonov S.S.S.R. c. 637 (U.S.S.R.)

[35] Decree of June 17, 1932, [1932] Sobranie Zakonov S.S.S.R. c. 281 (U.S.S.R.). The amended rules of procedure, which were approved by decision of the Presidium of the All-Union Chamber of Commerce, Jan. 21, 1949, appear in ECONOMIC COMMISSION FOR ASIA AND THE FAR EAST, CONFERENCE ON TRADE PROMOTION 4 (Doc. No. Trade/59) (1951). The text of the decree and the rules may also be found in Papers on Appeal in Amtorg Trading Corp. v. Camden Fibre Mills, Inc., 277 App. Div. 531, 100 N.Y.S.2d 747 (1st Dep't 1950).

[36] Pisar, *Treatment of Communist Foreign Trade Arbitration in Western Courts*, in MARTIN DOMKE (ED.), INTERNATIONAL TRADE ARBITRATION: A ROAD TO WORLD-WIDE COOPERATION 101, 109 (1958).

[37] See, *e.g.*, the Treaty of Commerce and Navigation (with Annex) Between Denmark and the Union of Soviet Socialist Republics, of Aug. 17, 1946, 8 U.N.T.S. 201, reading in its pertinent articles as follows:

"Art. 14. The settlement of any disputes which may arise in connection with contracts relating to commerce between the two Parties may be effected by means of arbitration. Each Contracting Party shall be prepared, at the request of the other Party, to enter into negotiations with a view to concluding an agreement regarding the best method of arbitration, on uniform lines, based on the principle of parity, and also regarding the method of enforcing arbitration awards. The provisions of such agreements shall have retroactive effect.

"Art. 15. Any disputes relating to commercial agreements concluded between State economic organizations of the U.S.S.R. and Danish physical or juridical persons shall, in the absence of a reservation regarding arbitration, be subject to the jurisdiction of Danish courts if the transaction was concluded in Denmark, and to the jurisdiction of the courts of the U.S.S.R. if the transaction was concluded in the Union of Soviet Socialist Republics. Nevertheless, the courts of the other Party shall have the right to determine disputes whenever their competence with regard to these disputes is definitely provided for by a condition specifically stipulated in the contract."

[38] Its pertinent art. 17 is translated in SECRETARIAT OF THE UNITED NATIONS, *op. cit. supra* note 33, at 15.

[39] For further instances of Soviet commercial arrangements relating to arbitration with Czechoslovakia (1947), Bulgaria (1948), and Switzerland (1948), see *id.* at 16.

[40] The set of circumstances surrounding the famous Lena Goldfields arbitration, under a concession agreement of April 30, 1925, which provided for appointment of arbitrators from higher academic institutions in Sweden, no longer appears pertinent. The text of the detailed arbitration clause (para. 90 of the agreement) is reprinted in the SECRETARIAT OF THE UNITED NATIONS, *op. cit. supra* note 33, at 18. *Cf.* Nussbaum, *The Arbitration Between Lena Goldfields, Ltd. and the Soviet Government*, 36 CORNELL L. Q. 31 (1950).

unfavorably by the business community of the Western world.[41] Since this decision may constitute the context in which future arbitration arrangements with planned-economy trade organizations will have to be considered, some examination of its details would seem to be appropriate.

The Foreign Trade Arbitration Commission of the All-Union Chamber of Commerce of the Soviet Union forms the pattern for arbitral bodies in countries having a similar economic structure—*e.g.*, Czechoslovakia,[42] Poland,[43] Bulgaria,[44] Rumania,[45] Hungary,[46] East Germany,[47] Yugoslavia,[48] and Communist China.[49] It consists of a panel of fifteen persons who are appointed for one-year terms. These appointees are drawn primarily from Soviet commercial, industrial, and communications organizations, although law professors having special knowledge of foreign trade are also frequently included. Each party to a dispute selects an arbitrator from the panel. In the event that these two are unable to reach agreement, they select a third arbitrator from the panel; and if they cannot agree upon one, the Chairman of the Commission makes the selection. There is no appeal from the awards of the

[41] *Infra* note 57.

[42] See Landa, *Note on Court of Arbitration of the Chamber of Commerce of Czechoslovakia*, 83 JOURNAL DU DROIT INTERNATIONAL 452 (France 1956). The Decree of the Ministers of Foreign Trade and of the Interior of June 30, 1952, on the Organization of a Czechoslovakian Chamber of Commerce and the statute and arbitration rules of the Chamber were considered by the Swiss Federal Tribunal in Linga v. Baumgartner & Co., A.G., Bundesgericht, Feb. 12, 1958, 84(I.) Entscheidungen des Schweizerischen Bundesgerichtes [hereinafter S.B.G.] 39 (Swit.). For an analysis of these rules, see AD HOC WORKING GROUP OF ARBITRATION COMMITTEE ON THE DEVELOPMENT OF TRADE, ECONOMIC COMMISSION FOR EUROPE, HANDBOOK OF NATIONAL AND INTERNATIONAL INSTITUTIONS ACTIVE IN THE FIELD OF INTERNATIONAL COMMERCIAL ARBITRATION 93 (Doc. No. Trade/WP1/15, Rev. 1) (1958) [hereinafter referred to as HANDBOOK].

[43] The Court of Arbitration of the Polish Chamber of Foreign Trade was established by para. 4(14) of the Decree of the Ministers' Council of September 28, 1949, to develop and intensify the commercial relations of Poland with foreign countries. See *Arbitration Organized by the Polish Chamber of Foreign Trade*, Polish Foreign Trade, Sept.-Oct. 1950, p. 68. Arbitral decisions are published in ORZECZNICTWO SADOW POLSKICH I KOMISJI ARBITRAZOWYCH [DECISIONS OF THE POLISH COURTS AND OF THE ARBITRATION COMMISSION] (1957). *Cf.* HANDBOOK 157.

[44] See Sipkov, *Foreign Trade, Chamber of Commerce, and Foreign Trade Arbitration Commission under Communist Government*, in U.S. LIBRARY OF CONGRESS MID-EUROPEAN LAW PROJECT, HIGHLIGHTS OF CURRENT LEGISLATION AND ACTIVITIES IN MID-EUROPE 423, 432 (1956). *Cf.* HANDBOOK 88.

[45] On the Foreign Trade Arbitration Commission of the Rumanian Chamber of Commerce, see HANDBOOK 162.

[46] On the Arbitration Court of the Hungarian Chamber, see *id.* at 135.

[47] See SCHIEDSGERICHTSORDNUNG DES SCHIEDSGERICHTS BEI DER KAMMER FUER AUSSENHANDEL DER DEUTSCHEN DEMOKRATISCHEN REPUBLIK (1957). For an analysis of the rules of the Arbitration Court attached to the Chamber of Commerce of Foreign Trade, see HANDBOOK 189.

[48] See *Rules of the Court of Foreign Trade Arbitration of the Chamber of Commerce of Yugoslavia*, Official Gazette of the Federated People's Republic of Yugoslavia, No. 26, March 28, 1947; *Rules of Conciliation*, Nov. 24, 1948, Commercial Information of the Chamber of Commerce, No. 3, 1949, p. 24. *Cf.* HANDBOOK 212. See also Goldstajn, *Arbitration and Arbitration Procedure in Yugoslavia*, 2 AM. J. COMP. L. 588 (1958), and *Submission to Arbitration of Disputes with a Foreign Element*, 5 JUGOSLOVENSKA REVIJA ZA MEDUNARODNO PRAVO 118 (1958); *New Rules for Foreign Trade Arbitration (Yugoslavia)*, 1959 J. BUS. L. 198.

[49] A Foreign Trade Arbitral Tribunal of the China Committee for the Promotion of International Trade was established by resolution of the Administrative Council of the People's Republic on May 6, 1954. Provisional rules of procedure (38 articles) were adopted on March 31, 1956. A German translation of the resolution and the rules appears in 3 OSTEUROPA RECHT 121 (1957).

Commission.[50] In 1941, an official report was issued, encompassing about five years work of the Foreign Trade Arbitration Commission, either in full reports or in abstracts, covering twenty-nine cases decided during that period. These cases concerned disputes between Soviet state-trading organizations and Belgian, Canadian, Dutch, Egyptian, English, French, German, Greek, Norwegian, and Swedish parties.[51] It was before this Foreign Trade Arbitration Commission that the Israeli-Soviet oil arbitration took place.

In 1953, two Israeli companies, Jordan Investments, Ltd., and Delek Israeli Fuel Corporation, entered into contracts with a Soviet state-trading agency, Soiuzneft-eksport, for the purchase of petroleum products, to be delivered f.o.b. Black Sea ports. Similar contracts were subsequently signed for the purchase of petroleum products during 1957 and 1958. All of these contracts were concluded in Moscow and contained the usual clause providing for arbitration in Moscow.[52] On November 6, 1956, after Israeli troops had entered the Sinai Peninsula, Soiuznefteksport advised the Israeli companies that the Ministry of Foreign Trade had withdrawn export licenses for the balance of petroleum products to be delivered in 1956, and that no export licenses would be granted for deliveries in 1957 and 1958. Soiuznefteksport then canceled the contracts, relying on a *force majeure* clause excusing a nonfulfillment which "rests on any circumstance that is beyond the control of the defaulting party."[53] The Israeli companies were thus obliged to find and transport petroleum from other sources and suffered heavy losses as a result.

In October 1957, one of the companies, Jordan Investments, Ltd., invoked arbitration in Moscow, demanding damages of $2,396,440. Thirteen hearings took place between January 19, 1957 and June 19, 1958, before three arbitrators, all members of the Foreign Trade Arbitration Commission. Within an hour of the close of the last hearing,[54] the arbitrators dismissed the Israeli company's claim. The motivated award was made and signed on July 3, 1958.

[50] Unlike the awards of the Maritime Arbitration Commission, from which an appeal lies to the Supreme Court of the Soviet Union, which may set an award aside and remand the case to the Commission "if the existing laws are contravened or wrongly applied in the award." See art. 24 of the rules of procedure of the Foreign Trade Arbitration Commission, *supra* note 35.

[51] See SECRETARIAT OF THE UNITED NATIONS, *op. cit. supra* note 33, at 18. See also Rashba, *Settlement of Disputes in Commercial Dealings with the Soviet Union*, 45 COLUM. L. REV. 530 (1943); EBERHARDT PFUHL, DIE AUSSENHANDELS-UND SEEARBITRAGE DER U.S.S.R. (1953); LEO A. YARESH, ARBITRATION IN THE SOVIET UNION (Research Program on the U.S.S.R.-East European Fund, Inc., Series No. 52, 1954). For a further survey of other arbitral bodies in countries with planned economies—*e.g.*, Hungary, Bulgaria, and Rumania—see Benjamin, *Aperçu des institutions arbitrales de l'Europe de l'est qui exercent une activité dans le domaine de l'arbitrage commercial international*, in 1957 REVUE DE L'ARBITRAGE 114; 1958 *id.* at 2.

[52] The clause reads as follows: "Any disputes which may arise out of the fulfilment of the present contract or in connection with it are to be settled by the Foreign Trade Arbitration Commission of the U.S.S.R. Chamber of Commerce in Moscow in conformity with the rules of said Commission. The decisions of said Commission are to be final and binding upon both parties."

[53] Clause 7 of the contract provides for the discharge from liability for nonperformance of the contract if such nonperformance is due not only to causes of *force majeure* enumerated in the clause—*e.g.*, disasters of nature, blockades, strikes, etc.—"but also to any other cause beyond the control of the defaulting party."

[54] This fact of only "about forty minutes" of deliberation was expressly mentioned in the N.Y. Times, June 20, 1958, p. 1, col. 1, p. 2, col. 5. Case No. 16/1957.

Here is a situation where the Soviet Government had instructed one of its instrumentalities to renege on its contractual commitments. Soiuznefteksport did not protest the order. Up to this point, the situation would seem to be one that might have occurred in any other country. The familiar pattern was upset, however, when the governmental instrumentality appeared as a party before an arbitral body which consisted solely of arbitrators bound to uphold an official policy which was implicit in the instrumentality's action.

Although this is not the place to review the arbitration award on its merits—*i.e.*, whether, even under the applicable Soviet law,[55] a trading organization which is part of the Government, cannot be held responsible for the acts of the Government—several points must be noted. Article twenty-one of the rules of procedure of the Foreign Trade Arbitration Commission provides that each party "must prove the circumstances which it refers to as grounds for its claims or objections."[56] Yet, the Commission prevented the lawyers representing the Israeli company from submitting this essential proof. The Israeli counsel claimed that the seller's duty to carry out the contract under any circumstances is an accepted rule of Soviet law and, when the Soviet defense counsel denied that statement, asked permission to call a Soviet legal authority to so testify. The Commission, however, refused this request, nor would it allow any Soviet witnesses to testify on questions of fact, especially as to whether the export organization had tried to save the contract, or on the prevailing Soviet practice for granting export licenses.

Indeed, the arbitration proceedings per se—apart from the award itself dismissing the claim—evoked highly critical comment throughout the world;[57] and it raises a number of vital questions concerning Soviet foreign trade arbitration in general.[58]

The first question is whether arbitration tribunals of countries with planned economies are really impartial bodies, willing and able to decide issues on their merits, or whether they are, in fact, only the mouthpieces of their governments. In other words, is there the probability or even the possibility that a fair determination adverse to some national policy of the arbitrators' country may be reached? A presumption of such impartiality not only has colored the prevailing opinion of

[55] *Cf.* Agarkov, *The Debtor's Discharge from Liability When Performance Is Impossible*, 29 J. COMP. LEG. & INT'L L. (3d ser.) 9 (1947).

[56] See *supra* note 35.

[57] See, *e.g.*, The Times (London), June 30, 1958, p. 7; Financial Times (London), June 27, 1958, p. 8; Manchester Guardian, June 27, 1958; Journal of Commerce (N.Y), July 3, 1958, p. 6; Berlingske Tidende (Copenhagen), June 23, 1958; Nieuwe Rotterdamsche Courant (Rotterdam), July 10, 1958; Neue Zuercher Zeitung (Zurich), July 5, 1958; Die Welt (Hamburg), June 24, 1958; Aussenwirtschaftsdienst des Betriebs-Beraters (Heidelberg), Sept. 1958, p. 187; *id.*, Feb. 1959, p. 36.

[58] See the recent German language literature on Soviet foreign trade arbitration, and references therein to further source material. *E.g.*, Awjerino, *Das Recht der Aussenhandelsgeschaefte der Sowjetunion*, 1 RECHT DER INTERNATIONALEN WIRTSCHAFT 181, 184 (1955); 1 CARL-HANS BUETOW, DAS GEGENWAERTIGE INNERSTAATLICH GEREGELTE AUSSENHANDELSRECHT DER UdSSR UNTER BERUECKSICHTIGUNG DER ZWISHENSTAATLICHEN VERTRAEGE 232 (1956); Pfuhl, *Gewaehrleistung und Garantie im zwischenstaatlichen Aussenhandel des Ostblocks*, 2 RECHT IN OST UND WEST 116 (1958).

Western legal writers,[59] but has also been judicially recognized.[60] Thus, the New York Court of Appeals, in *Amtorg Trading Corp. v. Camden Fibre Mills, Inc.*, staying a court action instituted by a Pennsylvania corporation against the New York agency of the Soviet Government until arbitration had taken place, said: "Camden chose to do business with Amtorg and to accept as one of the conditions imposed, arbitration in Russia; it may not now ask the courts to relieve it of the contractual obligation it assumed."[61] However, it should be noted that the court expressly reserved to the Pennsylvania corporation the right to take "appropriate action should the arbitration in fact deprive it of its fundamental right to a fair and impartial determination."[62]

In *Linga v. Baumgartner & Co., A.G.*,[63] the Swiss Federal Tribunal, in a decision of February 12, 1958, reversed a decision of March 15, 1957 of the Zurich appellate court, which had confirmed a lower court,[64] and granted execution of an arbitral award rendered under the rules of the Court of Arbitration of the Czechoslovakian Chamber of Commerce in Prague. Neither the composition of the tribunal of exclusively national (Czechoslovakian) arbitrators nor the proceedings themselves was held sufficient, under the Swiss-Czechoslovakian Treaty concerning the Recognition and Enforcement of Judicial Decisions of December 21, 1926,[65] and the Geneva Convention on the Execution of Foreign Arbitral Award of September 26, 1927,[66] to deny enforcement on public policy grounds.[67] The court, in fact, expressly refuted the challenge that in view of the state monopoly of foreign trade in Czechoslovakia, the Chamber of Commerce could no longer be considered a neutral institution, because it has primarily to serve the interests of the state. Holding that the

[59] See, *e.g.*, Schaer and Luther, *Bericht ueber die Durchfuehrung eines Schiedsverfahrens vor der Aussenhandels-Arbitragekommission der UdSSR in Moskau*, 2 RECHT DER INTERNATIONALEN WIRTSCHAFT 75 (1956); von Beringe, *Rechtsfragen bei Handelsgeschaeften mit der Sowjetunion*, 11 DER BETRIEB 859, 862 (1958).

[60] See Pisar, *Soviet Conflict of Laws in International Commercial Transactions*, 70 HARV. L. REV. 593, 611 (1957), and *Treatment of Communist Foreign Trade Arbitration in Western Courts*, in MARTIN DOMKE (ED.), INTERNATIONAL TRADE ARBITRATION: A ROAD TO WORLD-WIDE COOPERATION 101 (1958).

[61] 304 N.Y. 519, 521, 109 N.E.2d 606, 607 (1952).

[62] *Ibid.*, referring to the N.Y. Civil Practice Act, art. 1461-62.

[63] Bundesgericht Feb. 12, 1958, 84 (I.) S.B.G. 39 (Swit.).

[64] The unpublished decision of the appellate court is noted by Pisar, *Treatment of Communist Foreign Trade Arbitration in Western Courts*, in MARTIN DOMKE (ED.), INTERNATIONAL TRADE ARBITRATION: A ROAD TO WORLD-WIDE COOPERATION 101, 105 (1958).

[65] 12 AMTLICHE SAMMLUNG DER BUNDESGESETZE UND VERORDNUNGEN DER SCHWEIZERISCHEN EIDGENOSSENSCHAFT 348 (1926).

[66] 92 L.N.T.S. 301; text also in MARTIN DOMKE (ED.), INTERNATIONAL TRADE ARBITRATION: A ROAD TO WORLD-WIDE COOPERATION 285 (1958).

[67] The challenge was based on earlier Swiss decisions that awards are not to be enforced if the arbitral tribunal lacks independence (*Unbefangenheit*), or if one party has a privileged position (*Vorzugsstellung*) before it, Lunesa Watch S. A. v. Federation Suisse des Associations de Fabricants d'Horlogerie und Konsorten, Bundesgericht, Dec. 7, 1955, 81 (I.) S.B.G. 321, 331; and that this principle was also applicable to foreign awards. Biedermann v. Brodr. Justesen, Bundesgericht, May 17, 1950, 76 (I.) S.B.G. 121, 128. See Guldener, *Die Gerichtsbarkeit der Wirtschaftsverbaende*, and Piaget, *Les jurisdictions institutées par les associations economiques*, 11 ZEITSCHRIFT FUER SCHWEIZERISCHES RECHT (N.F.) pt. 2, at 208a, 271a (1952).

law of the state where the arbitration proceeding was held is applicable, the court said (translation):

> It would be going too far to admit, for the determination of international commercial controversies, only arbitral tribunals which are composed either evenly of nationals of the states of both parties or of the nationals of other countries. . . . It is not appropriate and not reconcilable with the principle of good faith to submit to the arbitral body of a foreign state with different political and economic conditions and then subsequently contest the impartiality of that arbitral body because of those conditions.[68]

The composition of planned-economy arbitral tribunals has, indeed, been the primary basis for challenging submissions thereto. While it is true that representation of foreign parties by foreign lawyers is allowed[69] and no refusal of visa for entry and sojourn in the country has yet been reported,[70] the arbitrators themselves have exclusively to be citizens of that country.[71] Nor is there any sign that this shortcoming will easily or quickly be remedied. Safeguards such as those included in arbitration rules of the International Chamber of Commerce,[72] the American Arbitration Association,[73] or the Japan Commercial Arbitration Association,[74] which require that a single arbitrator or the chairman of the arbitration board be of a nationality other than that of either party to the proceedings, will not, in all probability, be adopted.

The next question, then, is whether a wider choice of arbitration facilities, in tribunals other than those of the planned-economy country—*i.e.*, in the country of the other party or in a third (neutral) country—would be feasible. As noted above, a recent trade agreement between a Soviet organization and an American firm pro-

[68] Similarly, challenges of the enforcement of awards of the Foreign Trade Arbitration Commission in Moscow have been refuted by Turkish and Belgian courts. See Pisar, *Soviet Conflict of Laws in International Commercial Transactions*, 70 HARV. L. REV. 593, 612 nn. 54, 55 (1957).

[69] Art. 20 of the rules of procedure of the Foreign Trade Arbitration Commission, *supra* note 35, provides that the parties may conduct their cases before the Commission "either personally or through their representatives appointed by them at their own discretion; such representatives may be foreign citizens."

[70] Hazard, *Soviet Commercial Arbitration*, 1 INT'L ARB. J. 96 (1946), observes that "representatives of the American principal may expect to obtain a visa for travel to the U.S.S.R. in connection with any hearing relative to the dispute."

[71] *E.g.*, art. 2(3) of the Rules of the Court of Foreign Trade Arbitration of the Chamber of Commerce of Yugoslavia (1947) provides: "Only citizens of Yugoslavia may be elected to the post of an arbitrator." For further references to arbitration tribunals of planned-economy countries, see Pisar, *Treatment of Communist Foreign Trade Arbitration in Western Courts*, in MARTIN DOMKE (ED.), INTERNATIONAL TRADE ARBITRATION: A ROAD TO WORLD-WIDE COOPERATION 101, 103 n. 10 (1958); for statutory law of other countries excluding foreigners as arbitrators, see PIETER SANDERS (ED.), INTRODUCTION TO INTERNATIONAL COMMERCIAL ARBITRATION 15 (1956).

[72] Art. 7(3) of the rules (in effect since June 1, 1955) provides: "Sole arbitrators and third arbitrators must be nationals of countries other than those of the parties."

[73] § 15 of the rules (in effect since September 1, 1954) provides: "If one of the parties is a national or resident of a country other than the United States, the sole Arbitrator or the third Arbitrator shall, upon the request of either party, be chosen or appointed from among the nationals of a country other than that of any one of the parties."

[74] Art. 15(a) of the rules (in effect since March 15, 1950) provides: "In a case where one or more Arbitrators shall be appointed, the sole Arbitrator or the third Arbitrator shall, upon the request of either party to the dispute, be chosen from among the nationals of a country other than that of any one of the parties."

vided for arbitration in Sweden.[75] Furthermore, the service agreement of the All-Union Chamber of Commerce in Moscow with the Japan Commercial Arbitration Association of May 27, 1957,[76] provides that arbitration between Soviet foreign trade organizations and Japanese physical and juridical persons shall be had in the country of the defendant in a dispute or discord "which may arise from or in connection with this contract."[77] Moreover, countries with planned economies do allow agreement for arbitration of their commercial disputes with foreign traders in the country of the latter.[78] Thus, Yugoslav trade organizations in the recent past have repeatedly used the facilities of the American Arbitration Association for arbitration in New York City.[79]

Despite many objections to the arbitration tribunals of countries with planned economies, the fact that these institutions are internationally recognized bodies became unmistakably evident in the deliberations of the 1958 Conference on International Commercial Arbitration, held at the United Nations. In discussions concerning a Draft Convention on the Recognition and Enforcement of Foreign Arbitral Awards, in which representatives of eight countries with planned economies participated,[80] it was stated that permanent arbitration bodies, such as exist in those countries, should have the same standing as other *ad hoc* established arbitration tribunals of Western systems. This was decided by the Conference with respect to the most important aspect of commercial arbitration—the enforcement of awards rendered in a country other than that where execution is being sought.

The provision in article 1(2) that the convention embrace "not only awards made by arbitrators appointed for each case but also those made by permanent arbitral bodies to which the parties have submitted," was first suggested at the Conference by the Czechoslovakian representative;[81] but it was contested by the Israeli representative, who considered it superfluous, observing that "if the procedure followed by the permanent bodies was genuinely arbitral . . . there could be no such arbitration in a tribunal imposed by one State alone."[82] The Italian representative correctly noted that the crucial question was not "whether the body was permanent or specially appointed, but whether there was an element of compulsion in the submission,"[83] a viewpoint supported by the French representative, who characterized awards made by such bodies to which the parties were compelled to have recourse "the same as

[75] See text at note 40 *supra*.

[76] See JAPANESE ANNUAL OF INTERNATIONAL LAW 167 (1957).

[77] A similar provision appears in the arbitration clause in contracts under the Council for Mutual Economic Aid. See *supra* note 28.

[78] See BUETOW, *op. cit. supra* note 58, at 233.

[79] *E.g.*, Centroprom Export and Import Corporation. *Cf.* Goldstajn, *Submission to Arbitration of Disputes with a Foreign Element*, 5 JUGOSLOVENSKA REVIJA ZA MEDUNARODNO PRAVO 118, 122 (1958).

[80] See *supra* note 23 and 24.

[81] U.N. Doc. No. E/CONF. 26/SR.7, at 3 (1958), presenting an amendment, U.N. Doc. No. E/CONF. 26/L/10 (1958), based on the report of the Ad-hoc Committee on the Draft Convention, of March 28, 1955. U.N. Doc. No. E/2704, para. 25 (1955).

[82] U.N. Doc. No. E/CONF. 26/SR. 8, at 2 (1958).

[83] *Ibid.* "If the parties were bound to refer their disputes to that body, the procedure was of a judicial nature."

judicial decisions."[84] Although a Belgian amendment to insert "voluntarily" before "submitted"[85] was accepted by the Conference,[86] the Drafting Committee in its report questioned the need for this word,[87] and it was, in fact, deleted from the final text of the Convention.[88] Thus, it appears that permanent arbitration bodies in countries with planned economies, though state institutions with arbitrators appointed by state organs, are internationally recognized and accepted.

There is no doubt that the settlement of disputes arising out of state-trading transactions—and not only with countries with planned economies—should not be left to diplomatic negotiation, but should be administered by arbitration tribunals. Nevertheless, the recent Israeli-Soviet oil arbitration cannot easily be ignored. It is true that[89]

> . . . the general trend of commercial law everywhere is to move away from the restrictions of national law to a universal international conception of the law of international trade. New international conventions, universal commercial practices indicate the growing horizon of modern commercial law.

Still, at this juncture, no generalization can be ventured in the use of arbitration for the settlement of particular state-trading disputes. The parties must weigh the advantages and disadvantages. In short, they must consider "the domestic arbitral jurisprudence; the corporate or non-corporate nature of state trading organizations; the overall extent of state trading in a country's economy; and the world trade position and bargaining power of the state trader."[90] However, the legal uncertainty still prevailing in state-trading relations can hardly be better illustrated than by the recent Argentine Petroleum Nationalization Bill of November 12, 1958,[91] which reaffirms the autonomy of Yaciimientos Petroliferos Fiscale, the state agency, and which prohibits, in its article four, the signing of any contract, "whatever its denomination, containing clauses prejudicial to the Nation's economic independence or which might prejudice in any other manner the Nation's self determination."

[84] *Id.* at 4.

[85] *Id.* at 5.

[86] 25 votes for, 8 against, with 6 abstentions, after devoting the entire plenary session of May 26, 1958 to the debate on that question only. *Id.* at 8.

[87] *Id.* SR. 23, at 4.

[88] 24 votes for, 2 against, with 7 abstentions. *Id.* at 6.

[89] CLIVE M. SCHMITTHOFF, MODERN TREND IN ENGLISH COMMERCIAL LAW 354 (1957), quoted with approval by Goldstajn, *Submission to Arbitration of Disputes With a Foreign Element,* 5 JUGOSLOVENSKA REVIJA ZA MEDUNARODNO PRAVO 118, 123 (1958).

[90] Fensterwald, *supra* note 32, at 168.

[91] Law No. 14,773, of November 12, 1958, translated in Foreign Commerce Weekly, Dec. 27, 1958, p. 5.

STATE OPERATIONS IN GOLD AND FOREIGN EXCHANGE*

Edward Ames†

Introduction

This paper discusses the implications of state transactions in gold and foreign exchange. As used here, the term government includes (a) central banks, (b) treasuries, and (c) exchange-stabilization and exchange-control authorities.[1] Gold today is held mainly in bars of about ninety-one per cent pure metal worth roughly $14,000. They are stored either in the government's own vaults or (especially in recent years) on "earmark" with the Bank of England or the Federal Reserve Bank of New York. Foreign exchange includes bank deposits abroad and holdings of short-term securities, such as the United States treasury bills held by many foreign governments,[2] and commercial bills and acceptances, particularly in the United Kingdom.

Foreign exchange transactions arise when importers are paying their suppliers in the currency of the latter or when exporters are converting their earnings abroad into their own currency in order to cover their domestic operating expenses. Such transactions also arise because of capital movements among countries. Investors may purchase foreign securities because returns are higher or risks lower than those on domestic securities; or, having made such investments in the past, they may wish to invest their assets at home rather than abroad.

Finally, a currency is a commodity itself as well as a means to buy commodities or securities. Just as domestic businesses maintain cash balances at some desired level or some ratio to current spending (even borrowing so as to achieve this aim), so those engaged in foreign trade (or investments) may maintain (even at the cost of borrowing) cash balances abroad. Moreover, since world trade has been historically financed mainly in a few centers, notably London, it has often been desirable for traders to maintain bank balances in countries with which they actually have no direct commercial ties.

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[1] Interesting political aspects of the relations among these agencies cannot be treated in the space available. See, *e.g.*, Federal Reserve System, The Treasury—Central Bank Relationship in Foreign Countries (1951).

[2] There is no very sharp line between short and long-term investments. It will be assumed here that a line can be drawn between long-term investments (including equities) and short-term securities which represent basically cash balances held in one country by residents or governments of others.

I

GOVERNMENT FOREIGN EXCHANGE TRANSACTIONS

Government foreign exchange transactions are intended to maintain either a particular price structure or a particular level of international transactions. The occasion for such intervention is ordinarily that other events have undesired repercussions in the foreign exchange markets or closely related domestic economic activities.[3] These events include wartime conditions, internal inflation, or depression.

The government may control foreign exchange markets in two general ways. One way is to be a buyer (or seller) always willing to carry on any volume of transactions at a stated price.[4] Another way is to impose direct controls, which institute legal penalties designed to prevent sellers (or buyers) from entering the market in such a way as to cause the price or the volume of transactions to move from the desired level.[5]

A. Price-Support Operations

The currency of all countries is now mainly paper money, which is formally a "liability" of either the government or the central bank. ("Liability" is put in quotation marks, for in a country where paper money may not be converted into metallic, it is hard to describe the practical content of the term.) It is legal tender within the country, but not outside. If there is more than one type of currency, the various types may not be exchangeable at par.[6] Nominal exchange ratios can prevail only if someone is willing and able to buy or sell any amount of one currency in exchange for others at these ratios[7] or to restrict the holding of certain types of money.[8] If several currencies are used in international payments,[9] exchange rates will fluctuate, unless someone maintains the rates stable, either by buying and selling operations or by restricting the holding of these currencies.

All governments recognize that some international trade is necessary and desirable, and they recognize that the less the fluctuations in exchange rates, the easier will it be for traders to predict the costs and revenues from their operations,

[3] In extreme cases, however, control over international transactions may be an end in itself: in the Sino-Soviet bloc, state monopoly of foreign trade has been an important component of Marxist doctrine.

[4] In the same way, the United States Government controls agricultural prices by being willing to buy unlimited amounts of produce at a support price. Sellers will not usually sell for a lower price, since they know they may always sell to the Government at this price.

[5] Similarly, the Texas Railroad Commission controls the price of crude oil by limiting the amount of oil which any well-owner may pump in the course of a month.

[6] In the United States before the Civil War, the private banks which issued notes which circulated as money were of varying soundness and reputation, and a $10 note on one bank would not necessarily buy the same amount of goods as a $10 note on another bank.

[7] The United States Treasury must exchange at par $1 bills (and other silver certificates) against silver coin, and, in fact, will exchange silver certificates for Federal Reserve notes (higher denomination paper money) in any amount.

[8] Thus, the United States forbids its residents to hold monetary gold inside the United States. It is thus unnecessary for the Government to do anything internally to maintain the domestic rate of exchange of paper money for gold at $35 to one ounce (besides enforcing the prohibition).

[9] Forward markets and currencies which are valid only for certain purposes are cases in point.

and the easier, therefore, for them to conduct foreign trade. They have, in general, preferred to stabilize exchange rates for fairly prolonged periods and to have infrequent (if necessary, abrupt) changes rather than frequent minor changes.[10] They have often preferred, when faced with the threat of a temporary exchange rate instability, to limit entry into foreign exchange markets rather than permit actual fluctuations in exchange rates to take place. In some cases, government agencies have been given the sole right to hold foreign exchange.

Exchange rate policies of any one government are limited by those of others. If any one government reduces the value of its currency, it gives its exporters and domestic producers an advantage in world trade, since its goods become cheaper in foreign markets, while foreign goods become more expensive at home; simultaneously, it discourages imports. But if one country devalues, others may retaliate. Such competitive exchange depreciation was, in fact, one of the reasons for the establishment of the International Monetary Fund, which provides a forum for international consultation on exchange rate changes.[11]

When a government agency wishes to maintain some rate of exchange for its own currency, but sees that the price of its currency is falling, it can hold up the price by buying its own currency from foreigners, using either gold or its own foreign exchange holdings in payment. If the value of the pound is dropping in New York, the Bank of England may buy pounds in New York, using in payment funds on deposit in New York banks or buying dollars from the Federal Reserve System with gold.[12]

If a government has a supply of gold and foreign exchange (including what it can borrow from other countries or the International Monetary Fund) adequate to meet ordinary emergencies, and if it can expect the outflow caused by such emergencies to be offset by an inflow at some later date,[13] it can meet them by its ordinary price-support operations. If the emergency is severe or protracted enough, then the authorities will allow the exchange rate to fall (since they will consider

[10] At the end of 1958, Italy and Canada were the main trading countries whose currencies lacked a par value, and Italy has, in fact, stabilized its exchange rates for considerable periods.

[11] No country may borrow from the IMF if it has not set an initial par value for its currency without IMF objection. In fact, France devalued its currency in 1948 without Fund approval. The power to withhold loans is the main IMF weapon. Since a single violator of a price-fixing arrangement may, in fact, gain considerable advantages, it is clear that there are circumstances when the Fund's sanctions would be inadequate to deter violators. So far, the general dislike of price-cutting has prevented any major test of the Fund.

[12] Exporters of country *A* with deposits in country *B* banks draw checks on these deposits to pay for purchases of their own currency. These checks end up in the hands of the *B*'s central bank. Checks on banks in country *A* which these exporters receive in exchange (for deposit in their domestic bank accounts) may turn out to be checks drawn by the central bank of *B* against its foreign accounts in country *A*. No currency in gold is ordinarily shipped from one country to the other.

[13] The Suez crisis of 1956 created an expectation among traders that the British would have to increase imports and reduce exports to a point where Bank of England gold and dollar reserves would not be enough to support the price of $2.80 per £1. In anticipation of devaluation and/or severe restrictions on the acquisition of dollars, holders of sterling converted as much as possible into dollar balances or United States goods. The authorities, in contrast, were convinced that the emergency was temporary and sought temporary United States aid and a line of credit from the IMF. The authorities were correct, and a "return to sterling" began in late 1957.

their purchasing power insufficient to maintain it) or deny access to the foreign exchange market to some.

In the absence of government intervention or of countervailing private capital movements, an increase in a country's imports would force down its exchange rate, leading to a series of price adjustments. At the lower exchange rate, exports would tend to increase, but the internal prices of exported goods would rise to some degree to offset this cheapening. At the same time, the lower exchange rates would tend to make imports more expensive, reducing the demand for them, and hence their price abroad. Thus, internal prices in all countries and exchange rates would tend to change, with the changes being influenced also by traders' anticipations as to their magnitude and duration.

Government intervention stabilizes the exchange rate. Changes in imports of the sort just described would require the government to sell gold or foreign exchange reserves to support the exchange rates. Then, (in somewhat oversimplified terms) if the amount of money inside any country varies with gold reserves (so that an increase in a country's imports automatically decreases its money supply), and if internal prices vary with the money supply, exports will rise, imports will fall (since the price level at home is now lower), and the gold flow will tend to stop without any "structural" balance-of-payments problems—that is, problems which do not automatically correct themselves.

A country at war cannot, however, export much, since the government's internal purchases grow enormously. Its imports, however, tend to rise, because even normal internal demand cannot now be met, given government demand for goods; and wartime finance is usually inflationary, so that demand for imports rises above normal.

Likewise, an inflation not induced by war in a single country leads to rises in domestic prices (and hence reductions in exports), accompanied by increased demand for imports. These changes will force the government, if it is to maintain a given exchange rate, either to pay out gold and foreign exchange reserves or to restrict access to the foreign exchange market.

A depression in a single country has the opposite effect from an inflation. A decline in internal demand lowers prices, reduces imports (which are no longer as competitive at home), and increases the demand for exports.[14] If, however, the central bank ascribes the depression to lower investment and forces down interest rates to encourage business borrowing, there may arise a demand for foreign securities, on which yields will not have fallen, and hence a need for support of the exchange rate at the cost of foreign exchange reserves.[15] In general, the perversity of

[14] A major factor in postwar European thinking was the experience of 1929 and 1938, when declines in United States economic activity led to flows of gold into the United States. This experience seemed repeated in 1949, when a United States recession coincided with internal inflation in the United Kingdom. It was clearly not repeated in 1954 or 1957, when other United States recessions took place.

[15] In the United States recessions of 1953-54 and 1957-58, sharp declines in United States interest rates led American banks to move funds to London, where interest rates continued high. Thus, the United States lost gold despite the recession, rather to the surprise of most economists. See 40 FED. RESERVE BULL. 1126, 1127 (1954); 44 *id.* at 1131, 1132 (1958).

capital movements with respect to business cycle changes in the 1930's led to a tendency by governments after 1945 to treat capital movements as being separate from commodity movements and to subject them to distinct sets of controls.[16]

During the early 1930's, when the major industrial countries underwent more or less severe depressions, the problem of inflation assumed a special form. For any single country endeavoring to stimulate economic activity was apt to find that its efforts raised its internal price level and worsened its foreign trade position.[17] The problem then seemed to be that internal recovery could be achieved only at the cost of scarce foreign exchange reserves. The elaborate exchange controls of Germany, whose recovery was primarily induced by military expenditures, were the most dramatic, but not the only, example of this phenomenon.

In all these cases, government actions in the foreign exchange markets are designed to enable the government to carry out other policies without changing the exchange rate or finding itself without foreign exchange reserves. A government is never without internal financial resources—since as a last resort, it can always print paper money—but it may be seriously handicapped for lack of foreign exchange.

In special cases, moreover, a government must even consider the actions of nonresidents. Thus, the United Kingdom has a special problem in its sterling liabilities. These represent the sterling holdings of nonresidents, only part of whom are in the Commonwealth. In 1947, the United Kingdom, under United States pressure, allowed certain nonresidents the right to convert these holdings into United States currency, causing a loss of almost a billion dollars in foreign exchange reserves in a few months. The importance of London as a center for foreign deposits has had especial historic significance, but at present, a similar situation is increasingly noted in the United States. Thus, at the end of 1958, foreign short-term assets in this country amounted to about $16,000,000,000, while United States gold reserves totaled $20,600,000,000.[18] The chances of a general removal of these assets seem as small at present as did the chances of a liquidation of the sterling balances in England in the last century.

Thus, the stability of foreign exchange markets cannot be dissociated from government operations. The government, in the narrow sense, wants to maintain exchange rate stability without undue risk of running short of foreign exchange. But the government, in the broader sense, intervenes in these markets because its other economic operations affect and are affected by them. If it feels that its sales of gold or foreign exchange are temporary and that business conditions will alter in such a way as to enable it to stop selling gold (or even to buy back what it has sold), it may have no compelling reason to do anything.[19] If, however, all foreign exchange

[16] See JOHN H. WILLIAMS, POSTWAR CURRENCY PLANS esp. cc. 9, 11 (2d ed. 1945).

[17] RAGNAR NURKSE, INTERNATIONAL CURRENCY EXPERIENCE (1944), gives an excellent discussion of the relation between internal stability and the international position of central banks in the interwar period.

[18] 45 FED. RESERVE BULL. 155, 210 (1959).

[19] The IMF distinguishes between "structural" troubles and those which will correct themselves. It will lend foreign exchange in the latter, but not in the former situation. The problem, of course, is to diagnose a trouble correctly.

reserves are apt to be spent, (1) the exchange rate must be abandoned as untenable, (2) exchange controls must be instituted, or (3) internal government policies leading to the loss of reserves must be abandoned. The last possibility is frequently the most efficacious, but can only be touched on here.[20]

B. Foreign Exchange Controls

Foreign exchange controls may be most intricate.[21] They differ (1) according to the number of control systems a country has, and (2) according to the variations in exchange rates permitted.

A control system is a rule under which a buyer of foreign exchange is permitted to use foreign exchange.[22] A transaction in goods and the corresponding foreign exchange transaction are authorized within certain quantitative limits, so that the market price is available only up to a certain volume of business, even if both parties are willing to do more.[23] Imports or exports beyond the limit may be allowed, subject to a penalty or premium rate of exchange. At the basic rate of exchange, however, buyers or sellers are willing to buy or sell more than they are permitted by the government.

Such control requires that no importer bring goods into the country without government consent. The only sure way of enforcing the rule is by seeing to it that only the government has foreign exchange (including gold) with which to make payments. But if exporters must sell their foreign exchange earnings to the government[24] and if registration of foreign assets[25] held by residents of the country is required, normal sources of foreign exchange earnings are channeled into government accounts, and payments out of these accounts are made subject to controls.

This sort of system centralizes a country's foreign exchange in government hands.[26] The government may maintain a par value on those transactions with nonresidents and conduct transactions with its own residents at prices which differ

[20] The discussion in this paper all runs in terms of losses of foreign exchange reserves. Actually, inflows of foreign exchange assets and gold may also provide special problems. Thus, since 1950, German policy has been to try to avoid an increase in these assets without allowing price increases, which are anathema in a country whose monetary system has twice completely collapsed in forty years. The acquisition of $6,000,000,000 in gold and foreign exchange is a remarkable achievement, and the problems caused by it, like all embarrassments of riches, are somewhat less urgent than those discussed here.

[21] The *Annual Reports on Exchange Restrictions* published by the International Monetary Fund are the most complete single cataloging of the restrictions in the postwar period. For the interwar period, see HEINRICH HEUSER, CONTROL OF INTERNATIONAL TRADE (1939).

[22] Technically, the buyer may require a license to import foreign goods, or an authorization to pay for them in the exporter's currency, or both. Administrative problems may arise where one license, but not the other, is granted; but these will not be discussed.

[23] Similar controls may exist over exports, so that sales beyond a certain limit are not authorized. In Ames, *Economic Integration in the European Soviet Bloc*, in AM. ECON. ASS'N, PROCEEDINGS (1958), the writer has outlined some aspects of economic equilibrium in trade of this sort.

[24] If exports require a license, exporters may be required to deposit with the government accounts abroad a sum equal to the invoice value of their exports within a stated period after the goods leave the country. The government will then reimburse them in their own currency on the basis of their exchange-control rules.

[25] Such registration, however, has proved particularly hard to enforce.

[26] In the postwar period, over half of the United States bank deposits of foreigners have been official; and many of the private deposits are, in fact, only temporary.

widely from the par values. It may, in principle, in trade with *n* countries involving *m* commodities have *n* x *m* different effective exchange rates and *n* x *m* rules governing foreign exchange transactions. The larger the number of separate controls and exchange rates, the more difficult it is to operate the system purposefully, as the greater becomes the administrative cost and the less the intelligibility of the rules to their administrators. Without actually importing and exporting on its own account, however, the government can produce an incentive for private businesses to execute many of the same transactions a government trading agency would carry on in its own name.

The first major type of exchange control is a control over the selection of partner countries (or, more properly, currencies) by residents engaging in foreign trade. Countries where internal prices are high (relative to exchange rates) are more attractive as markets for exports and less attractive as sources of imports. Such countries, however, are apt to be countries which themselves have exchange controls. That is, their governments refuse to provide third currencies to importers, so that their trading partners will be forced to buy from them as well as sell to them (thus reducing the pressure on their foreign exchange reserves). Just as devaluation may provoke retaliation, so may exchange controls. If country *A* normally uses its exports to *B* to pay for its imports from *C*, *B*'s exchange controls may interfere with this transfer and perhaps lead *A* to limit its trade with *B*, unless *B* permits transfer.

This tendency toward bilateral trade and exchange controls in Europe after World War II[27] was only gradually overcome, as European economic conditions improved, using the Organization for European Economic Cooperation and later its offspring, the European Payments Union. A general reduction in European exchange rates (increase in European gold prices) in September 1949 provided a rough correction for the greater wartime price rise in Europe than in the United States, so that in 1950, the European Payments Union re-established, with some limitations, general multilateral exchange within Europe. Restrictions on trade with the United States and Canada continued, but were gradually relaxed, since the prices in these countries rose more rapidly in the 1950's than European prices, reducing the pressure on European reserves.[28] At the end of 1958, most of the remaining controls on the ability of nonresidents to convert European balances into dollars were removed, and restrictions on European trade with dollar countries were lessened. Thus, this type

[27] In considerable degree, European prices were abnormally high because of wartime demand inflation and damage to plant. Reconstruction was, of course, speeded by United States Government aid, a subject of great importance, but beyond the scope of this paper. Greater European output would, in these circumstances, decrease (rather than increase) demand for United States goods, tend to increase exports, as plant resumed production, and thus decrease the general pressure on European exchange reserves, permitting decreases in exchange controls.

[28] At the end of 1950, the United States had gold reserves of $22,800,000,000, and European countries had $7,300,000,000 plus $2,900,000,000 in short-term claims on the United States. At the end of 1958, the United States had gold reserves of $20,600,000,000, and European countries had $13,400,000,000 plus $7,800,000,000 short-term claims on the United States. International Financial Statistics, March 1959, pp. 16, 36.

of control, which predominated in the early postwar period, has become relatively unimportant.

A second major type of exchange control is over the types of commodity in foreign trade. This control is particularly important in so-called underdeveloped countries, where governments are trying to industrialize more rapidly than business processes would normally allow. In such a country, higher-income groups tend to buy foreign goods or land rather than invest in domestic industry; and any investment requires imports of capital goods. Government investment is apt to be financed by inflation (where there is no local capital market or a poorly developed tax system), so that the programs lead not only to large capital goods imports, but also to increased luxury consumer goods imports; and exports tend to be priced out of world markets.

The exchange-control system in these countries, then, offers favored rates to importers of capital goods and to exporters, so as to permit the government to avoid the drain on foreign exchange of its development program. With the general improvement in the European payments situation since 1949, this type of exchange control is probably the most prevalent today.[29]

Whether the controls be set up by country or by commodity, licensing involves (1) selection of firms eligible to receive licenses, and (2) periodic changes in licenses given to any category of trader. Very complicated questions of law arise in daily administration of such systems, and they cannot be treated here.

Two special types of control should be mentioned, albeit without much discussion. The first connects an import to an export transaction: businesses producing for sale in a low-cost (hard-currency) area may purchase raw materials in low-cost areas or even receive a general import license as a reward for their sales; or importers from high-cost (soft-currency) areas may receive some low-cost area license as a reward for their efforts. The second permits unlimited sales or purchases of foreign exchange of certain areas (or for certain purposes), the price of the exchange being, however, at a rate which is allowed to vary with demand and supply. Thus, the government might fix an exchange rate for necessary imports and allow that on luxuries to fluctuate.

Two consequences of exchange-control systems should be indicated. The first is that the internal prices of a country may vary without reference to variations in world prices. Where domestic prices would ordinarily be conditioned by world prices (since importers and exporters alike will take advantage of differentials, when

[29] One reflection of the change in the nature of global exchange controls is found in the geography of United States foreign aid. Whereas in 1949, the United States spent $4,500,000,000 in foreign aid to Europe and $1,300,000,000 in aid to Asia, the corresponding figures (excluding military aid) in 1957 were $5,000,000,000 and $1,700,000,000, respectively. Survey of Current Business, April 1950, p. 20; *id.*, April 1958, p. 22. Moreover, while European gold and foreign exchange reserves were rising, as indicated in note 28 *supra*, Asiatic reserves fell from $4,400,000,000 to $4,100,000,000. These changes correspond roughly to (1) the solution of wartime inflationary problems in Europe, and (2) the appearance of inflationary development finance in Asia.

permitted to do so, thereby limiting price differences), exchange controls break this link.

The second consequence is the involvement of the government in exchange equalization.[30] Even if import and export licenses balance international payments without changes in gold and foreign exchange reserves, the government still has to settle with businesses in its own country. That is, it collects domestic money from importers (who have bought foreign currency from the government) and sells domestic money to exporters (in payment for the foreign currency they have earned). In order to encourage exports and discourage imports, so as to reduce the drain on its foreign exchange reserves, a government may pay a premium on the former and a penalty on the latter; this means an implicit devaluation.

If the controls are successful, they create domestic industries which may never be able to compete successfully on world markets. If the government later wishes to remove the controls, it may find important internal vested interests to oppose it. If domestic and world prices differ, the government may have to subsidize export industries or find itself dependent on profits earned from the sale of imports internally. Concentration of foreign exchange in government hands thus isolates internal prices from world prices and has important and complex internal repercussions. The most enthusiastic proponents of exchange controls would argue that there are cases where the pattern of resource utilization thus achieved can be more desirable than that which would be achieved otherwise. Particularly in the underdeveloped countries, the view is held that economic development (industrialization) requires the abandonment of market processes and hence exchange controls.

It is, of course, hard to determine the effectiveness of these various control systems. Even under as elaborate and efficient controls as those of the United Kingdom in the late 1940's, traders were apparently able to move up to $400,000,000 and an equal amount in European currencies in and out of the United Kingdom, merely by shifting from thirty-days' arrears to thirty-days' prepayments on ordinary commercial transactions (the Bank of England could not control these transactions more closely within the limits of ordinary business practice) and cause very great erratic short-term shifts in British reserves.[31] And there is ample evidence that countries plagued by persistent monetary expansion have found it most difficult, even with controls, to prevent imports from rising more than exports.[32] An extensive controversy has raged between those who have maintained that exchange controls were primarily a reflection of monetary inflation and would be unnecessary in a country with ade-

[30] The writer attempted a concise explanation of the fiscal consequences of separating domestic and international prices in Ames, *The Exchange Rate in Soviet-Type Economics,* 35 Rev. Econ. & Stat. 337 (1953). This article explains the bookkeeping of a conceptually simple system of complete controls, which is perhaps useful in understanding the more complex cases here discussed, where internal and world prices are more or less free to fluctuate.

[31] See Katz, *Leads and Lags in Sterling Payments,* 35 Rev. Econ. & Stat. 74 (1953).

[32] How else can one explain the persistent failure of efficient governments of law-abiding populations to avoid undesired losses of foreign exchange, as in England from 1945-50 and Scandinavia generally since 1945?

quate credit controls,[33] and those who have maintained that exchange controls reflected mainly nonmonetary difficulties within the country which might be expected to continue to threaten a country's foreign exchange reserves regardless of the monetary policy it might pursue.[34]

Final resolution of the dollar-shortage problem into monetary and nonmonetary components would be a monumental task and cannot be undertaken here.[35]

II

FOREIGN EXCHANGE ASSETS

All exchange-control systems concentrate foreign exchange in government hands and thereby raise interesting political problems. On the one hand, a government's foreign exchange is a bank deposit and is of interest to foreign exchange-control authorities. If these choose, they can freeze it, cause it to be depreciated, limit payments from it, and so on. On the other hand, one government cannot injure other governments without inviting retaliation. A system of protocol among central bankers has developed to eliminate petty irritations, although, of course, major differences of interest cannot be easily settled.[36] The possibility of such retaliation increases the desirability of having gold rather than currency as a country's reserve.

The analysis of a country's foreign assets is somewhat deceptive, for similiarities in procedure may conceal important differences in substance. In the absence of exchange controls, a country's foreign assets indicate earnings which are an effective source of purchasing power. However, with exchange controls, quite a different situation may exist. Thus, during World War II, the Germans made large purchases in Danubian and Balkan countries (and had considerable military expenses for troops stationed there). These expenses were paid for in marks and credited to bank accounts in the names of the respective countries, increasing the foreign exchange assets of the latter. On the other hand, the bank accounts could not be used, and the transaction had the same nature as loans to Germany. German purchases, moreover, had internal inflationary consequences in these countries. It seems unlikely that these countries would have wished to finance Germany to this extent in the absence of German troops in their vicinity.[37]

[33] The annual reports of the Bank for International Settlements (Basle) are perhaps the most effective current analyses from this point of view.

[34] The annual *Economic Survey of Europe*, published by the United Nations Economic Commission for Europe (Geneva), provides forceful expression of this view, particularly in the first decade after the war. See also British Labor Party viewpoints, as expressed notably by Gaitskell, Kaldor, and Balogh. THOMAS BALOGH, THE DOLLAR SHORTAGE (1949), in particular, provides an early statement of this nonmonetary view.

[35] See Furth, *The World Dollar Problem*, 11 WORLD POLITICS 262 (1959).

[36] J. W. BEYEN, MONEY IN A MAELSTROM (1949), gives a combination of personal reminiscences and monetary analysis in which these aspects of international central banking are prominent. The author has played a prominent role in Netherlands central banking and also in the Bank for International Settlements and the International Monetary Fund.

[37] The wartime annual reports of the Bank for International Settlements are still the best source on this subject.

On the other hand, many members of the British Commonwealth allowed their balances with the Bank of England to rise greatly during the war, although Canada provided aid in a form basically analogous to lend-lease. Australian contributions to the United Kingdom during the war would not differ in form from Hungarian contributions to Germany; but the substance was different. While Canadian aid was in the nature of a donation, the sterling balances of the other Commonwealth countries were, in effect, loans, and they have been to a considerable extent repaid to enable them to finance postwar import surpluses.

The United States has never had exchange controls for balance-of-payments reasons, and for many years, it has been the largest owner of gold in the world. There has been no compelling reason for the United States Government to keep foreign balances for monetary purposes. However, since World War II, the United States Government has been involved in foreign exchange transactions for a variety of reasons. First, a large military establishment has been maintained abroad. Currency of the countries in which these troops are stationed is needed partly to pay the troops and partly also to pay local costs, including the construction of installations. Second, national security policies have permitted offshore procurement: the United States wishes to aid the defense program of country *X*; it purchases arms for *X* in country *Y*; it must, therefore, from time to time, make purchases of *Y*'s currency in connection with the aid program. The administrative arrangements under these headings are, of course, complicated in detail, and need not be dwelt on here. Some $1,100,000,000 was spent on offshore procurement in 1956-57.[38]

Third, the United States has been involved with a series of foreign central-bank balances which may be called counterpart funds. A government receiving United States aid under some programs deposits the local currency equivalent of the aid in special accounts, which may not be used without mutual agreement. Where these funds are the result of selling aid goods to the public, increases in counterpart reduce the cash assets of the public, and countries with inflationary problems have sometimes left the funds on deposit, or even used them to retire part of the public debt held by the central bank, so as to prevent their returning into circulation (this latter alternative is not now possible). Alternatively, they may be used as a substitute for tax revenue by the recipient of the aid. The United States normally claims credit for such internal expenditures, as having been financed by the proceeds of United States grant aid.

In recent years, the United States has particularly encouraged foreign countries to purchase surplus agricultural commodities by accepting payment for them in counterpart funds rather than in United States dollars, so that a country may increase its purchases from the United States without a drain on its exchange reserves.[39] This has the political advantage for the United States of causing farm goods in

[38] Survey of Current Business, April 1958, p. 21.

[39] In 1957 $600,000,000 net of such purchases took place out of total nonmilitary aid of $2,300,000,000. *Id.* at 20.

United States Government hands to disappear without spoilage, on the one hand, or the appearance of a "giveaway," on the other. The foreign country, in its turn, receives dollar purchasing power without either precisely accepting a gift or yet promising to pay dollars for it. And while the United States acquires foreign balances which are in some degree frozen—since they cannot, under international agreement, either be converted into dollars or used to pay for ordinary imports of the United States—its position with respect to the recipients of the surplus goods can hardly be compared to that of the Balkan countries with respect to Germany, or of Commonwealth countries with respect to the United Kingdom.[40]

CONCLUSIONS

The commitment to maintain a stable exchange rate and the need for foreign exchange have close connections with the entire course of a country's internal economic process. Internal events and, of course, the country's foreign policy taken in the broad sense have repercussions upon the country's foreign exchange reserves. These constitute the means by which the state can carry out its intentions internationally.

Analysis of these transactions inevitably, then, raises in technical terms the question of whether a country's internal economic development (influenced as it is by government action) is compatible with its international situation. As might be expected, it is not always easy to determine which affects which. In some sense, the absence of government action here implies a situation satisfactory to the government; but it cannot be inferred from the fact of government action whether the disturbance arises from without or within.

A considerable part of the technical interest of the subject lies in the difficult problem of deciding the precise consequences of any particular rule which a state may set forth governing its operations in gold and foreign exchange. Usually, a considerable variety of measures may have the same net effect on a country's international payments. In this case, then, the selection of a particular policy with regard to state transactions in gold and foreign exchange must be examined in terms of the government's internal objectives, given the state of the world economy. The transactions here mentioned have effects on the way internal economic processes work, so that it is quite possible for a country's internal and international economic policies to be in conflict. In this event, the decision as to whether internal or international considerations must prevail will depend upon the realities of the situation and the strength of the government's various commitments.

[40] At the end of 1957, the United States had about $1,700,000,000 of these foreign exchange assets. *Id.* at 22.

STATE TRADING AND INTERNATIONAL ORGANIZATION

J. E. S. Fawcett*

Introduction

The amount of good and harm done by state trading is a matter of some dispute among both politicians and economists. No attempt will be made to enter into this dispute in this study, which accepts as facts that state trading is, on the one hand, not in full harmony with the economic philosophy which underlies such international instruments as the General Agreement on Tariffs and Trade, while it is, on the other, an essential part of the commercial relations of Communist China, the Soviet Union, and like-minded countries. The purpose of this study, then, is to review what has been done by countries which have sought through international organization to limit the effects of state trading seen to be harmful; to consider some of the working arrangements that have been made for state trading between the countries of East Europe; and finally, to consider whether international organization can control state trading as an element in East-West trade.

I

International Organizational Efforts

The international case against state trading might be put on the following grounds: The state trader has a preference for bilateral agreements with importing or supplying countries, and so removes an important segment of trade from the area of free competition. State trading also inhibits competition and distorts commerce and production by yielding an artificial and excessive protection to domestic suppliers and by inducing inflation of prices of commodities for which the state trader is known to be in the market. Furthermore, the exercise by a state trader of internal monopoly, whether complete or partial, tends to be contagious, since other countries seek the same means of competing with, or protecting themselves from, the state trader. Finally, state trading may also be used by one country as an instrument of pressure upon or control of the economic life of another.

It has long been recognized that, for some of the reasons just suggested, there is a conflict between state trading and the most-favored-nation standard. The reciprocal grant of most-favored-nation treatment between a state-trading country and a private-trading country can result in concessions being made wholly on the side of the private-trading country: for the state trader may buy the goods to which the most-favored-nation privileges should attach in a third country against which it maintains

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a high tariff and then, being itself an arm of the government, obtain a refund of the duties imposed; for this reason, the import of goods from the private-trading country in the state-trading country would not be materially increased by the adoption of reciprocal most-favored-nation treatment.[1] A series of bilateral agreements,[2] which began with the Soviet Union-Latvia Commercial Agreement, 1927, was marked by an effort to strengthen the most-favored-nation clause in two ways: by a requirement that the Soviet Union purchase a fixed quantity of commodities over time, "a rough and ready way of attempting to put the relations between a free-enterprise and a state-trading country on an equitable basis";[3] and by the more insubstantial support of an undertaking that "so far as relates to the treatment accorded by each party to the trade with the other, they will be guided in regard to the purchase and sale of goods . . . to the employment of shipping . . . and all similar matters by commercial and financial considerations only. . . ."[4]

Similar principles were embodied in the trade agreement of 1938 between the United Kingdom and the United States. Article VIII(1) provided that where a monopoly was established or exclusive trading privileges were given to an agency by either contracting party, then first, the commerce of the territories of the other "shall receive fair and equitable treatment in respect of the foreign purchases of such monopoly or agency" (principle of nondiscrimination); and second, "such monopoly or agency will, in making its foreign purchases of any article, be influenced solely by considerations, such as those of price, quality, marketability and terms of sale, which would ordinarily be taken into account by a private commercial enterprise interested solely in purchasing on the most favourable terms."[5]

The first attempt to generalize these principles and give them a multilateral structure was made in the drafting of a charter for an International Trade Organization. A section of the Havana Charter, entitled "State Trading and Related Matters," was intended to subject import and export monopolies to a rule of nondiscrimination and fair commercial practice.[6] Article twenty-nine used the concepts and much of the language already familiar in bilateral agreements: state enterprises were to conduct their trade "in a manner consistent with the general principles of non-

[1] See Domke & Hazard, *State Trading and the Most-Favored Nation Clause,* 52 AM. J. INT'L L. 55 (1958).

[2] Treaty of Commerce Between the Union of Soviet Socialist Republics and Latvia, June 2, 1927, No. 1591, 68 L.N.T.S. 321; Treaty of Guarantee and Neutrality With Protocol Between the Union of Soviet Socialist Republics and Persia, Oct. 1, 1927, No. 2620, 112 L.N.T.S. 275; Commercial Agreement With the Union of Soviet Socialist Republics, July 13, 1935, 49 STAT. 3805, E.A.S. No. 81 (effective July 13, 1935); Commercial Agreement With the Union of Soviet Socialist Republics, Aug. 6, 1937, 50 STAT. 1619, E.A.S. No. 105 (effective Aug. 6, 1937).

[3] HARRY HAWKINS, COMMERCIAL TREATIES AND AGREEMENTS 202 (1951).

[4] Temporary Commercial Agreement Between the United Kingdom and the Union of Soviet Socialist Republics, April 16, 1930, No. 2340, 101 L.N.T.S. 409, 418 (denounced by the United Kingdom in 1934).

[5] Trade Agreement With the United Kingdom, Nov. 17, 1938, 54 STAT. 1897, E.A.S. No. 164 (effective Dec. 24, 1939).

[6] United Nations Conference on Trade and Employment, *Final Act and the Havana Charter for an International Trade Organization,* CMD. No. 7375, c. 4, § D, arts. 29-32 (1948).

discriminatory treatment prescribed in this Charter," and this was explained as requiring that

> . . . such enterprises shall, having due regard to the other provisions of this Charter, make any such purchases or sales solely in accordance with commercial considerations, including price, quality, availability, marketability, transportation and other conditions of purchase or sale, and shall afford the enterprises of the other Member countries adequate opportunity, in accordance with customary business practice, to compete for participation in such purchases or sales.

There had been also much discussion at the Havana Conference of the possibility of using the device of fixed purchase undertakings by state traders, already favored in bilateral agreements. This would have taken the form of an undertaking by state traders to negotiate annual purchasing commitments with the private-trading countries. The idea was finally discarded as impracticable, and the Conference had to content itself with article thirty-one, optimistically entitled "Expansion of Trade." This would have required any members of the proposed International Trade Organization maintaining or authorizing an import or export monopoly to

> . . . negotiate with such other Member or Members in the manner provided for under Article 17 in respect of tariffs, and subject to all the provisions of this Charter with respect to such tariff negotiations, with the object of achieving:
> (a) In the case of an export monopoly, arrangements designed to limit or reduce any protection that might be afforded through the operation of the monopoly to domestic users of the monopolized product, or designed to assure exports of the monopolized product in adequate quantities at reasonable prices;
> (b) in the case of an import monopoly, arrangements designed to limit or reduce any protection that might be afforded through the operation of the monopoly to domestic producers of the monopolized product, or designed to relax any limitation on imports. . . .

The goal of negotiation was to be "the establishment of the maximum import duty that may be applied in respect of the product concerned," or "any other mutually satisfactory arrangement" if that were not feasible.

The maximum import duty was, in its turn, defined as

> . . . the maximum margin by which the price charged by the import monopoly for the imported product (exclusive of internal taxes conforming to the provisions of Article 18, transportation, distribution and other expenses incident to the purchase, sale or further processing, and a reasonable margin of profit) may exceed the landed cost. . . .

The Havana Charter did not include any definition of state trading or state enterprises, and section D ("State Trading and Related Matters"), from which the texts above are quoted, speaks indifferently of state enterprises and monopolies, though they are not necessarily the same thing, and makes a passing reference to "marketing boards, commissions and similar organisations."[7] However, in chapter five ("Restrictive Business Practices"), the Charter defines the term "public commercial enterprise" as meaning[8]

[7] *Id.* art. 30.

[8] *Id.* art. 54.

(i) agencies of governments in so far as they are engaged in trade, and
(ii) trading enterprises mainly or wholly owned by public authority provided the Member concerned declares that for the purposes of this Chapter it has effective control over or assumes responsibility for the enterprises. . . .

Strictly, this definition is for the purposes of chapter five, but if the Charter provisions are taken as a whole, it seems reasonable to assume that the drafters understood a "state enterprise" to be any agency of government, or for which a government is responsible, engaged in purchases and sales on government account.[9] However, it was recognized that, as in the field of state immunity, despite the difficulty of categorizing all governmental functions precisely, it was possible to give some sensible meaning to "governmenal use"; and article twenty-nine was not to apply to imports of products "for immediate or ultimate consumption in governmental use." Further, due regard was to be had to the fact that some monopolies are established for social, cultural, humanitarian, or revenue purposes.[10]

The Havana Charter never entered into force, but it has been necessary to review in some detail its provisions on state trading, since they have been carried over into the General Agreement on Tariffs and Trade (GATT).[11] Article seventeen ("State Trading Enterprises"), in its original form, laid down the same rules as article twenty-nine of the Havana Charter, in almost identical language. Further, article II-4 forbade the operation of an import monopoly in such a way as "to afford protection on the average in excess of the amount" provided for in the schedule of tariff concessions or as otherwise agreed between the parties negotiating a concession.

These pious undertakings, hardly susceptible of control, seem to have had little or no impact on state-trading practices, and in 1954, the contracting parties to GATT appointed a working party to consider a number of proposals on state trading. Acting on its report, the contracting parties introduced amendments to GATT in 1955 which were accepted by all but five. An interpretative note was appended to article II-4 stating that, in the absence of special agreement, the provisions of this paragraph should be "applied in the light of the provisions of Article 31 of the Havana Charter." Further, two paragraphs were added to article seventeen, requiring that the contracting parties be notified of all products subject to monopoly trading; that contracting parties operating an import monopoly on a product not the subject of concession in schedules inform the contracting parties, at the request of an interested country, of the import mark-up on such products; and that reports on the operation of monopolies be submitted to the contracting parties on request, in order that they may ascertain whether it conflicts with the provisions of GATT. A general exception from these requirements is made for the disclosure of confidential information

[9] Contrast the meaning given to "operated by a State" in the International Convention for the Unification of Certain Rules Relating to the Immunity of State-owned Vessels, April 10, 1926, arts. 1 and 3, and Additional Protocol, May 24, 1934, art. I, No. 4062, 176 L.N.T.S. 199, where governmental and commercial service are sharply distinguished.

[10] United Nations Conference on Trade and Employment, *supra* note 6, art. 31(b).

[11] 61 STAT. (5), (6) (1947), T.I.A.S. No. 1700 (effective Jan. 1, 1948).

which would impede law enforcement, or be otherwise contrary to the public interest, or prejudice the legitimate interests of particular enterprises.

Finally, article eleven, through an interpretative note, makes the rules on quantitative restrictions applicable to state trading, so that a state monopoly may not limit the quantity of imports or exports,[12] except as permitted by those rules.

In November 1958, the contracting parties established a panel which was to examine, among other things,[13]

> the notification sent to the Contracting Parties concerning the products imported to or exported from their territories by enterprises of the kind described in paragraph 1(a) of Article XVII, and to make practical suggestions to the CONTRACTING PARTIES with a view to improving the procedure for notifications under that Article.

From this, it appears that article seventeen, even as amended, has so far borne little fruit beyond "opportunities for negotiations and consultations between governments on the trading activities of State enterprises and of private undertakings enjoying exclusive or special privileges."[14]

Nevertheless, it may be useful to attempt a brief summary of these GATT provisions. They seek broadly to curb or eliminate two factors in state trading: undue protection of domestic producers, and trade discrimination.

Goods imported by a state trader may be subject to a tariff bound under GATT. If the state trader purchases all imports of a particular commodity, or a sufficient proportion to permit control of the price, it can, by reselling the imported goods at high prices, provide additional protection for domestic suppliers offering similar goods at lower prices. The benefit of the tariff binding to the foreign seller could then be nullified. The combined effect of articles II-4 and XVII-1 seems to be: First, if the state-trading country collects[15] the bound duty on the entry of the goods, it may not, on reselling them, increase the price above landed cost by more than a defined "import mark-up,"[16] which is virtually identical with the "maximum import duty" defined in the Havana Charter. Second, there is no obligation upon state traders to negotiate on the margin of protection for domestic suppliers, as there was in article thirty-one of the Havana Charter. However, negotiation is recommended, and it is presumably this which is covered by the interpretative note to article II-4, that it must be applied "in the light of the provisions of Article 31 of the Havana Charter."

The rule of nondiscrimination by state traders, effectuated through the "commercial considerations" clause, seems of little more effect than a declaration of intent. For "any agency having a monopoly would be acting in conformity with, rather than

[12] Thus, going further than Havana Charter art. 31(5), which covered only imports.

[13] GATT, CONTRACTING PARTIES, 13th Sess. 173 (Doc. No. SR. 13/17) (1958).

[14] GATT, COMMERCIAL POLICY, 1957, at 67 (1958).

[15] If it does not, it may add the equivalent of the bound duty to the resale price.

[16] Interpretative note to the General Agreement on Tariffs and Trade art. XVII-4(b), *supra* note 11. The paragraphs added in 1955 to the original art. XVII now require notification of import mark-ups to contracting parties.

departing from, 'commercial principles' and would be buying 'in the market which happened to be the most advantageous in each particular case' if it carried out skilfully the practice of 'discriminatory monopsony.'"[17] Further, it is far more difficult to establish international supervision of the buying and selling practices of a state-trading country, where much may be done by administrative decision, than over its tariffs and quotas: GATT allows that "the charging by a state enterprise of different prices for its sales of a product in different markets is not precluded [for article seventeen] provided that such different prices are charged for commercial reasons to meet conditions of supply and demand in export markets."[18]

In conclusion, the far more stringent provisions of the Rome Treaty[19] establishing the European Economic Community should be noticed. Article 37(1) provides that

> Member States shall progressively adjust any State monopolies of a commercial character in such a manner as will ensure the exclusion, at the date of the expiry of the transitional period [twelve years from January 1, 1959], of all discrimination between the nationals of Members States in regard to conditions of supply or marketing of goods.
>
> The provisions of this Article shall apply to any body by means of which a Member State shall *de jure* or *de facto* either directly or indirectly control, direct or appreciably influence importation or exportation between Member States. These provisions shall apply also to monopolies assigned by the State.

New measures tending to limit the effect of this undertaking are prohibited, and the Commission is charged with supervision of the manner and timing of the adjustments to be made. Article ninety also brings within the reach of all the rules contained in the Treaty "public enterprises and enterprises to which [member-states] grant special or exclusive privilege." It remains to be seen how these treaty arrangements will evolve.

II

SOVIET-BLOC ARRANGEMENTS

We may now turn to review very briefly some of the steps to organize state-trading relations which have been taken by countries, which are members of the Council of Mutual Economic Aid,[20] of General Conditions[21] to be inserted in foreign trade contracts to cover "all deliveries of goods between foreign trade organizations and member countries." There is some doubt whether the adoption of these condi-

[17] JACOB VINER, TRADE RELATIONS BETWEEN FREE-MARKET AND CONTROLLED ECONOMIES 75-76 (League of Nations Pub. No. 1943.II.A.4).

[18] Interpretative note to the General Agreement on Tariffs and Trade art. XVII-1, *supra* note 11.

[19] Treaty Establishing the European Economic Community, March 25, 1957, No. 4300, 298 U.N.T.S. 11, 29 (effective Jan. 1, 1958).

[20] The Council was established in 1949, and the present members are Albania, Bulgaria, Czechoslovakia, the German Democratic Republic, Poland, Rumania, and the Soviet Union.

[21] See Berman, *Unification of Contract Clauses in Trade Between Member Countries of the Council for Mutual Economic Aid*, 7 INT'L & COMP. L. Q. 659 (1958). This article contains a translation of the General Conditions with a commentary.

tions by a foreign trade organization is mandatory or simply recommended, but it seems that, in practice, they are likely to be extensively used. Some member-countries have[22]

> laid down in their bilateral trade agreements that their foreign trade organizations will in their mutual business contracts make use solely of these general conditions but even in such cases, it is provided that the parties may, in certain circumstances, agree upon exceptions.

The General Conditions are highly practical in form and seem to be the fruit of state-trading experience. Of particular interest are:

Paragraph 9, which provides as follows:

> If the buyer does not fulfill within the time stipulated in the contract any obligations for assuring the seller's production provided by the contract, or if the buyer subsequently changes data previously furnished by him, and if in connection with this there follow substantial difficulties for the seller, connected with production, then the seller shall have the right to adjust the time of delivery proportionately, though not longer than the time of delay on the buyer's part and of performance of the aforementioned obligation, and/or to demand compensation for the actual losses incurred in connection therewith. The seller shall be obliged to give the buyer timely notice of adjustment of the time of delivery.

By provision for damages, this secures such advantages as long-term contracts have to give by way of stability of production.

Paragraph 22: There are established varying periods of guarantee in which the seller remains responsible for the quality and prescribed characteristics of goods delivered.

Paragraphs 35, 36: Payment is made by "the bank of the seller's country"; the bank then debits the account of the "bank of the buyer's country," and settlement is made through clearing agreements. The commercial counsellor of the embassy of the buyer's country, called the trade delegate, is the recipient of the documents to be presented by the seller for payment.

Paragraph 65: In cases of dispute, arbitration is preferred to access to the "general courts," their jurisdiction being excluded; and, in fact, each of the member-countries has a permanent foreign trade tribunal.

Paragraph 72: No rights or obligations under foreign trade contracts between these countries may be assigned without the consent of the other party. Professor Berman observes of the whole scheme that "it adapts the institutional framework and technique of capitalist trade to trade between state enterprises of planned economies."[23]

[22] Letter from the Czechoslovak Permanent Representative to United Nations to Professor Harold J. Berman. *Id.* at 661.

[23] *Id.* at 664.

III

EAST-WEST TRADE

Nevertheless, the venture made in the Economic Commission for Europe "to subject to some form of international regime" trade between the state-trading countries of East Europe and other countries represented on the Commission has so far had little success. In 1956, the Soviet Union proposed an All-European Agreement on Economic Cooperation.[24] This proposal was conceived on broad lines, but contemplated that the Agreement would, in particular, deal with "trade and international payments, transport and communication, credit and banking, insurance, shipping and the like." Two articles of the Soviet draft agreement particularly concern us here:

Article 5. The participating States shall on a reciprocal basis grant to each other unconditional and unrestricted most-favoured-nation treatment with regard to all matters of trade and shipping between them and with regard to the status of natural and legal persons conducting business on the territory of any participating State subject to the conditions under which such activity is authorised by the law of such State.

A Contracting Party shall not apply with regard to the import from, or export to, the territory of another party any limitations, prohibitions or formalities not applied in this regard to all participating States.

. . . .

Article 7. In order to facilitate the exchange of goods and services in European trade, the participating States shall endeavour to use the method of multilateral settlements in their trade relations, and shall in particular instruct their central banks to take part in a multilateral compensation agreement prepared within the framework of the United Nations Economic Commission for Europe. . . .

Comments on the draft agreement were received from the countries participating in the Commission, and they were, in general, conciliatory, but sceptical. Apart from the countries of East Europe, whose comments were characteristically brief and formal, pleading for the adoption of the Agreement, members of the Commission joined in criticizing the draft of articles five and seven on two main lines: First, there were already a number of international agreements and agencies in the field, which, if properly employed and directed, could achieve the ends proposed in the draft. Second, the differences in economic structure and policy between the countries of East Europe and the rest would inhibit the operation of article five and defeat its intent.

The United Kingdom said:[25]

It is not clear how in practice one country can be satisfied that "most-favoured-nation" treatment is being accorded fully and without discrimination by another country where trade is carried on entirely or mainly by State agencies. Where trade is mainly governed by long-term contracts moreover, the "most-favoured-nation" principle can only operate at infrequent intervals, and not continuously. It is also exceedingly difficult to determine

[24] U.N. Doc. No. E/ECE/270, pt. 1 (1957).

[25] Observations of the Government of the United Kingdom, *id.* at 56-57.

when an organisation in such a country is resorting to what are commonly held to be unfair trading practices, e.g. "dumping," because of the special difficulties of ascertaining costs of production, including material costs.

Certain proposals also clearly imply trading practices, such as long-term commercial contracts, and a rigid framework of bilateral trading agreements, to which Her Majesty's Government does not generally subscribe, believing them not to be conducive to the expansion of world trade on a non-discriminatory basis.

The Netherlands observed:[26]

Another consequence of the essential differences between the various economic systems is that a particular provision or obligation in a treaty will, in many cases, have entirely different implications for one party as compared with another. A clear case of this nature is contained in Article 5. The granting of unconditional most-favoured-nation treatment in the fields of foreign trade, exchange rates, tariffs, etc., would be making a real concession as far as the Netherlands and countries with a similar economic system are concerned. On the other hand a most-favoured-nation clause obtained in such cases from countries where international commerce and the distribution of goods, etc., are subject to a system of state control, has in itself little practical value.

It is generally recognized that the most-favored-nation standard is largely ineffective in trade between state and private traders, and it is not altogether easy to account for the continued inclusion of a most-favored-nation clause in commercial agreements with state-trading countries.[27] It is in the nature of state trading that the government practicing it has in its hands a single instrument of economic policy, unlike the complex strands of private trade with which other countries grapple. The state trader blocks or opens or redirects the channel of imports and exports as his general plan dictates; but, in other countries, where trade policy is kept as close as practicable to an ideal structure of free competition between private traders, it cannot be subjected to uniform control, and no reciprocity between the systems is possible. Both aim to achieve a universal division of labor[28] by methods which are mutually exclusive, and hardly adaptable to international rationalization.

[26] Observations of the Government of the Netherlands, *id.* at 38, 39.

[27] See Domke & Hazard, *supra* note 1, at 66, suggesting some answers.

[28] See, *e.g.*, the deliberate plan for industrial and agricultural specialization within the East European bloc between 1959 and 1965. Nove, *Soviet Trade and Soviet Aid*, Lloyds Bank Review, Jan. 1959, p. 1.

CHANGING SOCIAL ARRANGEMENTS IN STATE-TRADING STATES AND THEIR EFFECT ON INTERNATIONAL LAW

W. Friedmann*

Introduction

Just as government-controlled navies came to replace the once predominant privateers, so state responsibility for the conditions of trading has increasingly replaced uncontrolled free trade, both internally and internationally. The extent of this shift in the conditions of international trade is, however, still obscured by the fact that we tend to take note only of the open and obvious changes in the organization of trade, as they occur through the socialization of resources and agencies. Thus, it is obvious that the Soviet Union and the other Communist states conduct all their foreign trade under a general economic plan and through the instrumentality of state-controlled official agencies. But it is less obvious that a vast number of states exercises far-reaching control over the international movements of goods and services from and into their countries through a variety of instrumentalities, such as currency control, tariffs, import quotas, selective permits for the importation of raw materials, and the like. Exporters or investors of the capital-exporting countries are, of course, well aware of the range and complexity of these controls. There is, however, a tendency to identify them with the special conditions prevailing today in the underdeveloped countries—either by virtue of economic necessity, or as a result of their political philosophy blending elements of nationalism and socialism, or a combination of both.

The folklore of private enterprise and free trade, more than any other factor, still largely prevents many people in this country—though not abroad, where the effects of the restrictions are keenly felt and observed—from realizing the extent of the official regulation of trade in this country. Free trade versus state trade is still considered to be a vital aspect of the ideological struggle in the cold war, but such incantations hardly alter reality. Trade has largely become an instrument of national policy in all the countries of the world, although the extent to which this means actual interference with the conditions of trade depends on the prevailing economic conditions of the country, rather than on purity of ideology. At most, it could be said of this country that "its external economic policies have displayed a fundamental

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ambivalence, wavering between partial measures of international cooperation and the espousal of policies of protectionism."[1]

A formidable case can be made for the proposition that United States economic policy—as indubitably that of the vast majority of other countries—has essentially been guided by national security and protectionist considerations, resulting in a battery of official directives and restrictions upon trade. This has been particularly noticeable in connection with the postwar economic involvements of the United States, such as Trade Agreements Extension Act of 1953,[2] the Foreign Assistance Act of 1948,[3] the various Mutual Security Acts,[4] and the escape clause included in the General Agreement on Tariffs and Trade at the insistence of the United States.[5] To these must be added the legislative controls imposed for specifically strategic and security reasons, such as the so-called Battle Act of 1951, which embargoes shipments of strategic materials to "any nation or combination of nations threatening the security of the United States, including the Union of Soviet Socialist Republics and all countries under its domination. . . ."[6] So powerful and varied is the armory of control mechanisms now at the disposal of the so-called free-trading states that, in times of war or grave emergency, a complete control over foreign trade in all its aspects can be imposed, without any need for socialization or revolutionary measures.

But while, from a functional point of view, the differences between state-trading and free-trading states appear to be greatly exaggerated, for purposes of legal analysis, they are still of vital importance. A private firm which, in order to conduct its export and import business, depends on a multitude of official permits and controls over supplies, exchange, and terms of payment still appears as a private subject conducting business, not as a state agency.

International law is predicated on the assumption of a general equilibrium of rights and obligations in the relations between the states which are the subjects of international law. In the field of international trade—in its widest sense—the tacit assumption has been that industry and trade are conducted privately, while governments confine themselves to the traditional functions of "nightwatchman" states—*i.e.*, defense, foreign affairs, and certain police functions. It is only on this assumption that the present rules of neutrality in regard to supplies to belligerents or the rules governing the immunity of foreign states from jurisdiction can be understood. The increasing activities and responsibilities of governments in the conduct of trading operations—either direct, or through state instrumentalities, or through controls at one remove—have put an increasing strain on the working of these rules. But it

[1] Miller, *Foreign Trade and the "Security State": A Study in Conflicting National Policies*, 7 J. PUB. L. 37, 47 (1958).

[2] Act of Aug. 7, 1953, § 103, 67 STAT. 472.

[3] 62 STAT., 22 U.S.C. §§ 1404(a), 1404(b), 1409, 1910 (1952).

[4] 65 STAT. 373 (1951), 22 U.S.C. § 1509 *et seq.* (1952); 66 STAT. 43, 22 U.S.C. §§ 272b, 281b *et seq.* (1952); 66 STAT. 141, 22 U.S.C. §§ 286b, 1503 *et seq* (1952).

[5] *Cf.* 65 STAT. 73 (1951), 19 U.S.C. § 1363 (1952); see 61 STAT. (5), (6) (1947), T.I.A.S. No. 1700 (effective Jan. 1, 1948).

[6] 65 STAT. 645, 22 U.S.C. § 1611 (1952).

was only with the General Agreement on Tariffs and Trade that the difficulty of formulating commensurable obligations for parties which operate their foreign trade through state agencies, on the one hand, and those which have private enterprise on the other, became quite openly apparent. Only then was an attempt made to cope with the problem explicitly.

It is, however, essential to understand that the problem is both older and wider than GATT. Indeed, it is a failure to look at the phenomenon of state trading and state control of trading as a general and important concern of contemporary international law that has accounted for a great deal of confusion and vacillation in the approach to the various subdivisions of the problem. The following brief observations will deal with four different aspects of the problem: first, government immunity from foreign jurisdiction; second, the equilibrium of neutrality obligations in trading with belligerents; third, the legal status of the government-trading corporation as a legal entity distinct from the government; and fourth, the attempt to create common rights and obligations between state-trading and private-trading states in a multilateral convention, such as GATT. This will be followed by some brief observations on the ways by which tensions created by the discrepancies of social structure can be overcome, or at least mitigated.

I

STATE TRADING AND SOVEREIGN IMMUNITIES

The principle of international law that foreign governments cannot be held subject to the jurisdiction of any municipal court of another country, because such assumption of jurisdiction would violate the principle of sovereign equality of the nations, has increasingly been strained, as one government after another has proceeded to engage in commercial transactions with international ramifications. Such activities and responsibilities extend far beyond the Sino-Soviet bloc. For example, the major shipping lines of Italy are government-controlled; and it is almost forgotten that during and following World War I, the United States Merchant Navy was state-owned. Certainly, the once prevalent theory that a state exercised government activities proper only as long as it did not enter trade[7] has long been abandoned. Even in the United States, it has been repeatedly held that the exercise of economic and commercial operations is as much a proper government activity as any of the more traditional government functions.[8]

Unfortunately, however, from the correct premise that "when, for the purpose of advancing the trade of its people or providing revenue for its treasury, a government acquires, mans and operates ships in the carrying trade, they are public ships in the same sense that warships are," and that, in the opinion of the Court, there is "no international usage which regards the maintenance and advancement of the eco-

[7] See, *e.g.*, Ohio v. Helvering, 292 U.S. 360 (1934).

[8] See, *e.g.*, New York v. United States 326 U.S. 572 (1946) (the *Saratoga Spring* case); Berizzi Bros. Co. v. S.S. Pesaro, 271 U.S. 562 (1926).

nomic welfare of a people in time of peace as any less a public purpose than the maintenance and training of a naval force,"[9] it has often been improperly deduced that the jurisdictional immunity of foreign governments must be extended to its commercial operations and assets. This is still the almost unchallenged jurisprudence of the courts in England,[10] which, despite occasional judicial doubts,[11] have refused to adapt the English judicial application of international law to drastically changed conditions. It is less emphatically maintained in the United States, where the so-called Tate Letter of 1952 stated the position of the United States Government to be that immunity should no longer be granted to foreign governments with respect to private acts (*iure gestiones*), and that "it will hereinafter be the Department's policy to follow the restrictive theory of sovereign immunity in the consideration of requests of foreign Governments for a grant of sovereign immunity."[12] But the practical effect of this doctrine, which appeared to bring United States practice more into line with predominant continental practice, has since been somewhat attenuated. In a recent case, an American company, wishing to sue the Republic of Korea for damage caused to its steamer by a lighter belonging to the Republic of Korea, had attempted to establish New York jurisdiction by seizing the defendant's assets in a New York bank. This the Government declared to be an inadmissible interference with the privileges of a foreign sovereign.[13] While not affecting the doctrine of qualified immunity as such, this decision certainly limits its practical application to situations where jurisdiction can be established in an ordinary manner and the foreign government may be expected to comply with an adverse judgment voluntarily.

The majority of continental countries has long adopted the doctrine of qualified immunity, ever since the decision of the Belgian cour de cassation in 1903 showed the way.[14] Generally, the doctrine of qualified immunity distinguishes between acts *iure imperii* and acts *iure gestiones,* but on the exact nature of the distinguishing tests, there remains controversy. For the reasons already outlined, any test which attempts to distinguish between "sovereign" and "nonsovereign" acts of government is fallacious. Even United States theory no longer maintains that governments, when engaging in commercial activities, do not act as "sovereigns." Neither is the test of the form of the transaction satisfactory. Without going into the details of this much debated question, it may suffice to say that the most satisfactory test yet developed

[9] Berizzi Bros. Co. v. S.S. Pesaro, 271 U.S. 562, 574 (1926).

[10] See, *e.g.*, Krajina v. Tass Agency, [1949] 2 All E.R. 274 (C.A.); Rahimtoola v. Nizam of Hyderabad, [1957] 3 All E.R. 441 (H.L.).

[11] Such as those voiced by Lord Wright in Compania Naviera Vascongado v. S.S. "Cristina," [1938] A.C. 485; and by Lord Denning in Rahimtoola v. Nizam of Hyderabad, [1957] 3 All E.R. 441, 463 (H.L.).

[12] 26 STATE DEP'T BULL. 984 (1952).

[13] New York and Cuba Mail S.S. Co. v. Republic of Korea, 132 F. Supp. 684 (S.D.N.Y. 1955).

[14] For the most recent survey, see Schmitthoff, *The Claim of Sovereign Immunity in the Law of International Trade*, 7 INT'L & COMP. L.Q. 452 (1958).

is that adopted in the Brussels Convention of 1926 by a number of continental states (but not acceded to by any of the major maritime powers), under which[15]

> Sea-going vessels owned or operated by States [and] cargoes owned by them . . . are subject in respect of claims relating to the operation of such vessels or the carriage of such cargoes, to the same rules of liability and to the same obligations as those applicable to private vessels, cargoes and equipments.

This is followed by specific exemptions for ships of war and other public vessels clearly not engaged in commercial operations. In other words, it is a test of the activity in question, the functional approach, which alone can lead to a satisfactory solution of this problem in an international society in which the trading responsibilities of governments cover the whole range of the spectrum, from remote and contingent control to direct operation.[16]

The most important task is to maintain a reasonable equilibrium between rights and obligations in international legal relations. This cannot be done by simply extending the sphere of government immunities to include a vast range of formerly uncontemplated commercial operations. This greatly extends immunity for commercial operations for some states, but not others. On the other hand, few, if any, states would be willing to dispense with government immunity altogether in this age of particularly high national sensibilities and sovereign claims. A meeting ground can, therefore, be only found on a functional level—*i.e.*, by judging the type of operation in question. It is towards such a middle ground that international law seems to be moving, albeit slowly and with insufficient support by the foreign offices and courts of some countries.

II

STATE TRADING AND THE DUTIES OF ABSTENTION IN THE LAW OF NEUTRALITY

Customary international law assumes that trading activities are in the hands of private enterprises. Therefore, the customary rules impose on neutral states as such only the duty of abstaining from certain active operations, such as the granting of loans or the supply of war materials.[17] But the international law, as formulated in the Hague Convention, does not forbid the citizens of neutral states to engage in commercial activities. Indeed, the supply of arms and other munitions of war has been an important source of sustenance for belligerents, especially where major industrial powers remained in a state of neutrality. To be sure, in the last two

[15] International Convention for the Unification of Certain Rules Concerning the Immunities of Government Vessels, Treaty Information Bull. No. 18, March 31, 1931, art. 1, p. 67.

[16] The more radical suggestion of the abolition in principle of governmental immunities, made by Lauterpacht, *The Problem of Jurisdictional Immunities of Foreign States*, 28 BRIT. YB. INT'L L. 220, 250 (1951), does not appear to be practicable at this stage of development in international relations. Moreover, the qualifications admitted by Judge Lauterpacht himself, such as the activities of "armed forces," introduce the same difficulty of distinction between commercial and noncommercial transactions.

[17] See Hague Convention (XIII) Concerning the Rights and Duties of Neutral Powers in Naval War, Oct. 18, 1907, art. 6, 36 STAT. 2428, T.S. 545 (effective Feb. 28, 1910).

World Wars, the sphere of neutrality has become increasingly restricted, because all the major powers sooner or later became involved. At the same time, moreover, the concept of contraband—*i.e.*, of goods liable to seizure—has expanded continuously to the point where the concept of noncontraband goods has become almost an extinct category. Hence, it would seem that this branch of neutrality has decreased in significance. It may, however, become more important under the conditions prevailing in our own days, when the fear of mutual destruction may, as we must fervently hope, prevent the world's major powers from engaging in direct war with each other, but when the possibilities of smaller wars between minor powers cannot be at all excluded. Under such conditions, it would become a matter of great practical as well as theoretical moment whether a state that directly controls production and trade in war materials should be subjected to stronger obligations of abstention than one in which these activities are carried on by private citizens. Over twenty years ago, the writer suggested that simply to apply the Hague rules of abstention to state-trading states would strain the equilibrium of international law to a breaking point, since it would tend to penalize a socialized or semisocialized country in its international operations.[18] The situation is, in a sense, the inverse of that described in the sphere of government immunities.

It is, however, easier to denounce the inadequacy and unworkability of the rule of international law than to substitute a new one. For, just as the old rules were based on a tacit assumption of equivalence of economic organization in the member states of the family of nations, so a new customary rule would have to be based on common principles of economic organization, which simply do not exist at the present time. Thus, the Harvard study on neutrality, published in 1939, while aware of the problem posed by the new developments, regarded widened duties of abstention on the part of state-trading states as the lesser evil and proposed an article expressly enjoining a neutral state to "abstain from supplying to a belligerent assistance for the prosecution of the war."[19] Similarly, Sir Hersh Lauterpacht, in a more recent edition of Oppenheim's *International Law,* contends that states having trade monopolies must abide by the existing rules.[20]

Although on paper this is the simplest solution, it will almost inevitably lead to a breakdown of the rules of neutrality in this field. When the major industrial powers are themselves engaged in war, neutrality—certainly, in the field of arms and contraband supplies—is relegated to an inferior position. But, even when the major industrial powers are not themselves belligerents, they are, given the precarious balance of contemporary international politics, actively interested in almost any local conflict that may break out—in Vietnam, Jordan, Iraq, or Cuba. It is, accordingly, neither likely nor reasonable to expect that a state-trading power will feel

[18] Friedmann, *The Growth of State Control Over the Individual and Its Effect Upon the Rules of International State Responsibility,* 19 BRIT. YB. INT'L L. 118 (1938).

[19] See Harvard Research in International Law, *Draft Convention on the Rights and Duties of Neutral States in Naval and Aerial War,* 33 AM. J. INT'L L. 237 (Supp. 1939).

[20] 2 H. LAUTERPACHT, OPPENHEIM'S INTERNATIONAL LAW 657 *et seq.* (7th ed. 1952).

bound by widened duties of abstention, nor will it passively watch a rival power sending vast supplies of arms and other vital material under the cover of outwardly private trade.

And even the cold logic of the rule is extremely doubtful. For as the experience of the last generation and the change in social organization, even in the free-trading states, have shown, there is not a state in the world today which cannot, and does not, in case of necessity, control the foreign trade flowing from and into its territory. Twenty-three years ago, the major powers of the Western and the Communist worlds had no legal or technical difficulty at all in concluding a nonintervention pact, with mutual obligations of abstention from supplying arms to either side in the Spanish Civil War. That the pact broke down was not attributable to any inability of any of the participating powers to implement its commitments by corresponding controls over its internal trade—which, indeed, have been exercised on many subsequent occasions, with complete success—but rather to basic political divergencies, which ultimately led to World War II. The fact that so-called free-trading states are today not only able, but expected to impose controls on their subjects, and that they have done so on many occasions, makes the extension of the old rules of neutrality so as to impose a far heavier burden on state-trading states even less acceptable.

A more realistic suggestion is that recently made by Julius Stone.[21] According to Professor Stone, the equilibrium should be restored by assimilating the trading activities of neutral governments to private trading by relieving, on the one hand, neutral governments of their duties of abstention from supplies, loans, etc. to belligerents, and subjecting them, on the other hand, to the liabilities of search and seizure for contraband goods, to which private traders are exposed under the rules of international law. This proposal, while theoretically elegant, meets, however, with the practical difficulty, that neutral governments are unlikely to tolerate search and possible seizure of their own vessels by the armed forces of belligerents, and this would be particularly unlikely in the most practical contingency—namely, of major industrial powers being neutrals and smaller powers being belligerents. Perhaps this difficulty could be somewhat mitigated where the government's trade is carried not in directly government-owned vessels, but through the instrumentality of semiautonomous state-trading corporations, on which some further observations will be offered below.

For the time being, however, it would seem that the only realistic hope lies in *ad hoc* solutions—such as were attempted in the Spanish non-intervention agreement —*i.e.*, in agreements between a number of states concerned in a particular situation. In such cases, it may be possible to obtain agreement on total abstention or on limitation of supplies to certain categories of goods. But it is certainly too early to look, at this stage, for a new universal rule of international law, as it is unrealistic to believe that the old rules, as formulated in the Hague Conventions, can effectively survive.

[21] JULIUS STONE, LEGAL CONTROLS OF INTERNATIONAL CONFLICT 408 *et seq.*, 413 (1954).

III

THE STATUS OF THE GOVERNMENT-TRADING CORPORATION IN INTERNATIONAL LAW

The failure to see the problem of changing social functions of government in its entirety has led to a particularly noticeable confusion and vacillation of thinking in regard to the government-trading corporation. This institution has developed in a large number of countries out of the need to combine, in the words used by President Roosevelt in his message to Congress of 1933, asking for the establishment of the Tennessee Valley Authority,[22]

> a corporation clothed with the power of government but possessed of the flexibility and initiative of a private enterprise.

It is, therefore, a deliberate combination of public and private law aspects. Machinery and personnel of government bureaucracy were found increasingly unsuitable to establish and manage complex industrial and commercial enterprises on behalf of the government. Hence, it was particularly important for legislators, in the creation, and for courts, in the interpretation, of the status of these corporations to reflect on the extent to which, given their purposes and functions, they should be clothed with public or private law attributes.

Such systematic thinking on the status of public commercial enterprises has gone farthest in Great Britain, in connection with the postwar nationalization of basic industries. A somewhat comparable development has taken place in France—again, in connection with the postwar nationalization of certain industries and utilities in the form of *établissements publics*. In other continental countries, such as Italy, where public commercial enterprise is of great importance, the form is less clearly characteristic, since government trade operates mainly in the form of stock companies in which the Government has the controlling interest. In the United States, where publicly-owned enterprises, such as the Tennessee Valley Authority, have a form comparable to the British pattern, clear legal thinking on their status has been obscured by the widespread prejudice against the very concept of public enterprise and the unfortunately successful attempts of Congress, in the Federal Tort Claims Act of 1946,[23] to shackle the federal public corporations closely to the budgetary control of a politically-minded and pressure-sensitive Congress.[24]

It is, nevertheless, possible at this stage to distil from the manifold forms of state-trading enterprises in a large number of countries certain characteristics. In a summary of the analysis attempted by the present writer elsewhere,[25] a recent writer,

[22] 77 CONG. REC. 1423 (1933).

[23] 60 STAT. 843 (1946), 28 U.S.C. §§ 1291, 1346, 1402, 1504, 2110, 2401, 2402, 2411, 2412, 2671-80 (1952).

[24] For a far more enlightened and systematic concept of the status of the public corporation in the State of New York, see the recent NEW YORK TEMPORARY STATE COMMISSION, REPORT ON PUBLIC AUTHORITIES (1956).

[25] Friedmann, *International Public Corporations*, 6 MOD. L. REV. 186 (1943); see also, for a later and more detailed analysis, Friedmann, *A Theory of Public Industrial Enterprise*, in A. H. HANSON (ED.), PUBLIC ENTERPRISE 11 (1955); and the *Comparative Analysis*, in W. FRIEDMANN (ED.), THE PUBLIC CORPORATION 539 *et seq.* (1954).

defining the term "state-trading enterprise," used but not defined in the General Agreement on Trade and Tariffs, has described the main features as:[26]

. . . autonomy of legal and financial status, non-political management, long-term financing by government appropriations by shares subscribed by the government and absence of control by private shareholders, this latter being exercised by government departments. To come under the category of "public commercial enterprise" these agencies should carry on trade on behalf of the government.

According to the above definition, however, trading enterprises owned mainly or wholly by public authority are public commercial enterprises, provided that either the member concerned declares that it has effective control over it, or assumes responsibility for it. . . .

This definition includes not only the public corporation proper—*i.e.*, the public commercial enterprises specifically established for the purpose of carrying out certain government purposes—but also those commercial companies in which the government has acquired a controlling interest. This is entirely proper, since the accident of legal form should not determine the legal status of the enterprise in international relations.

If the courts of the different countries in which, in connection with particular litigation, the status of such enterprises had to be established, had reflected on their status in connection with the wider problem of government immunities, they should clearly have come to the conclusion that the device of the trading enterprise as a separate legal entity was to be understood as separating, for purposes of legal liability, that enterprise from the general status of government. Since it is generally regarded as desirable that the sphere of government immunities should at least not be extended beyond its original meaning, such an interpretation—which, incidentally, corresponds to that laid down internally for the public corporations of Great Britain, the dominions of the British Commonwealth, and the public authorities of the State of New York—would have neatly and elegantly disposed of the problem of government immunities in regard to commercial trading enterprises.

In the many countries where the former doctrine of absolute immunity has been replaced by that of qualified immunity—*i.e.*, where commercial state operations do not partake of governmental immunities—the problem is not so serious. It is, however, serious in countries such as Great Britain or the United States, where a doctrine of qualified immunity has, as yet, not been clearly developed. Unfortunately, the courts in these countries have either wavered or altogether failed to grasp the problem. Thus, in the most recent English decision on the subject, the Court of Appeal applied the doctrine of immunity of foreign governments from national jurisdiction to a Spanish Government corporation charged with the import and export of grain for the Government.[27] And in a previous decision, which rested primarily on the assumption that the Tass Agency was not a separate corporation, but

[26] V.A. SEYID MUHAMMAD, THE LEGAL FRAMEWORK OF WORLD TRADE 229 (1958).

[27] Baccus S.R.L. v. Servicio Nacional del Trigo, [1957] 1 Q.B. 438 (C.A.).

a part of the Soviet Government machinery, one of the justices specifically made the applicability of the immunity doctrine dependent on whether the enterprise was constituted in the form of a public corporation proper (immunity applicable) or of a joint-stock company controlled by the Government (immunity nonapplicable).[28] This, of course, is a wholly unsatisfactory and formalistic distinction which can only serve to increase friction in international commercial disputes.

While occasional American decisions have taken a more enlightened approach,[29] the majority of the United States courts, too, have failed to adapt the law to the new social facts. Thus, in *Berizzi Bros. Co. v. S.S. Pesaro*,[30] the Supreme Court reversed the decision of a district court which had held an Italian merchant vessel, owned and operated by the Italian Government and engaged in carrying olive oil from Italy to the United States, subject to a libel in rem. While affirming correctly that the carrying on of trade by a government was a public purpose, the Court deduced from it that the immunity had to be applied. Again, in a more recent decision of a district court, immunity was granted to the Anglo-Iranian Oil Company, on the ground that the British Government held a controlling interest in its voting stock and that the purpose of the company was to ensure oil supplies for the British Navy.[31]

The prevailing traditional approach of the common-law countries, which has just been referred to, is clearly undesirable as well as illogical from the point of view of international law. In the present state of international society, international law must aim at maintaining or developing rules that ensure the general equilibrium of rights and responsibilities among states that differ widely in their political and economic philosophies and organizations. It is neither possible nor desirable for international law to outlaw or discriminate against state-trading enterprise. Such an attempt would only disrupt what remains of international community. Neither is it desirable, from an international legal point of view, that the accident of public control of a commercial operation should confer a privileged status, through exemption from legal responsibility. The answer which has been tentatively provided by the Brussels Convention for any government-owned vessels is even simpler and more obvious in the case of separately constituted state-trading corporations. For purposes of legal status and liabilities, they should be held quite clearly distinct from the government for which they act. Since there is little prospect of a general international convention on this matter, however, it can only be hoped that the courts, and in particular the courts of the common-law jurisdictions, will modify a legal theory which has neither logic nor justice.

[28] Krajina v. Tass Agency, [1949] 2 All E.R. 274 (C.A.).

[29] *E.g.*, United States v. Deutsches Kalisyndikat Gesellschaft, 31 F.2d 199 (S.D.N.Y. 1929), where an agency for the sale of potash controlled by the French Government was held to be a commercial concern and, therefore, not within the ambit of government immunities.

[30] 271 U.S. 562 (1926).

[31] *In re* Investigation of World Arrangements with Relation to Production, etc., of Petroleum, 107 F. Supp. 628 (D.D.C. 1952), 13 F.R.D. 280 (1953). The majority of the American decisions is in accord. See the note in W. W. BISHOP, CASES AND MATERIALS ON INTERNATIONAL LAW 427 (1953).

IV

STATE TRADING IN GATT

In one sense, the status of state trading in a multilateral convention such as the General Agreement on Tariffs and Trade, which attempts to lay down rules binding on a large number of states, ensuring fair play and nondiscrimination in international trade, forms part of the wider problem with which we have dealt so far: how to deal with the discrepancies in economic organization between the nations in such a manner that neither private-trade nor state-trade states enjoy discriminatory advantages in relation to each other. In another sense, however, GATT presents a different problem. For here—for the first time, as far as we are aware—the need to lay down general rules of conduct made it necessary to face the problem of state-trading directly and articulately.

The basic principle of GATT is that of nondiscrimination, and the main instrument for carrying out this principle is the most-favored-nation clause. Accordingly, article seventeen provides that state enterprises established, maintained, or granted by a contracting party must, in purchases or sales involving import or export, act on the principle of nondiscrimination. This means that the purchases and sales by state-trading enterprises shall be conducted on "commercial considerations"—*i.e.,* that they should be directed by such factors as price, quality, availability, marketability, and transportation—and that the enterprises of other contracting parties—*i.e.,* private traders—must be afforded adequate opportunities to compete in the purchase or sale in accordance with customary business practices. Conversely, no contracting party must prevent any enterprise—state or privately-owned—from acting in accordance with these principles.

Brief reflection on the basic differences in the motivation and operation of foreign trading in state-trading states and private-trading states—even those latter which, like the great majority of contemporary states, support private trading by subsidies, quotas, tariffs, and the like—shows how difficult it is, in effect, to apply the principle of nondiscrimination.

For an international economy which is at least basically directed by private-enterprise and free-trade ideals, the most important single instrument of legal support for an expansion of international trade has been the most-favored-nation clause. As formulated in article one of GATT, this means that[32]

> any advantage, privilege or immunity granted by a contracting party to a product originating in or destined for any other country . . . should be immediately and unconditionally accorded to similar products originating in or destined for the territories of all other contracting parties.

The most-favored-nation clause does not, as such, lead to a direct increase of trade between two or more states. But by guaranteeing equality of treatment to rival commercial states in the markets of a third state, and by thus eliminating dis-

[32] See, for a recent survey, SEYID MUHAMMAD, *op. cit. supra* note 26, c. 5.

criminatory burdens, especially those imposed through tariffs and customs duties, the clause serves to expand international trade under free-market conditions. Any concession, any advantage granted, under free-enterprise conditions by one state to another would extend to the commercial enterprises of any other state benefiting from the clause. The duty of the government under the clause is, in free-trade conditions, essentially one of abstention; the obligation is not to interpose obstacles to the trade flowing between private parties.

But a state which conducts its own trade, through the government itself or through state-controlled corporations, buys and sells, lends or borrows, supplies or hires services, as part of an official economic policy. It tends to operate by way of specific agreements which implement this policy: by barter deals, by special loan or technical assistance agreements, by bulk purchases or sales. Hence, the most-favored-nation clause cannot have the same meaning for such a state as it has for a differently-organized state. Thus, the first commercial agreement between the Soviet Union and the United States, of July 13, 1935, accorded most-favored-nation treatment (except for purchase of coal) to the Soviet Union in the American markets, but the Soviet Union, instead of reciprocally responding, was asked to commit itself to purchase in the United States commodities of a specified value within a given period.[33] The British-Soviet Commercial Agreement of April 1930, too, attempted to restore a measure of meaning to the most-favored-nation treatment of a state-trading partner by a protocol, in accordance with which the parties undertook to eliminate from their mutual economic relations all forms of discrimination and to be "guided in regard to the purchase and sale of goods, in regard to the employment of shipping and in regard to all similar matters by commercial and financial considerations only. . . ." The subsequent denunciation of the Agreement was explained by a British Cabinet member in the following words:[34]

> It is impossible to work a normal most favoured nation clause as an automatic piece of commercial policy, when, on one side, you have a private individual acting as a trader, merchant, broker, shipowner, and so on, and on the other side a State which can control the whole of the commercial transactions into and out of a country.

In the words of a recent commentator:[35]

> The clause cannot operate to encourage expansion of trade by opening markets on a non-discriminatory basis to low-cost producers because factors other than cost and tariffs influence the decisions of state-trading buyers. In short, the most-favored-nation clause has proved itself to be no longer a sufficient desideratum for private-enterprise states in their commercial relations with state-trading states to constitute a *quid pro quo* for important tariff concessions by private-enterprise states.

Yet, the state-trading nations of the Sino-Soviet bloc have been insistent on the use of the most-favored-nation clause—for example, in a recent Soviet proposal to in-

[33] 49 STAT. 3805 (1935), E.A.S. No. 81 (effective July 13, 1935). *Cf.* Domke & Hazard, *State Trading and the Most-Favored-Nation Clause*, 52 AM. J. INT'L L. 55, 57 *et seq.* (1958).

[34] Lord Runciman in 286 H.C. DEB. (5th ser.) 1291-92 (1934).

[35] Hazard, *Commercial Discrimination and International Law*, 52 AM. J. INT'L L. 495 (1958).

clude an unconditional most-favored-nation clause in an All-European Agreement on Economic Cooperation.[36] They have explained this desire as an expression of the principle of sovereign equality in the relations of nations, as a symbol of nondiscrimination, rather than an instrument of active expansion of trade.[37] But after the unsuccessful experiments of the interwar period, it is unlikely that a general agreement on these lines, between state-trading nations and the others, will be possible. General trade agreements, such as GATT, based on the most-favored-nation clause are likely to remain limited to states and share at least a minimum of common organization and principles in the conduct of trade. And even in the relations between these states, serious rifts have already occurred, because some of the parties depart more significantly than others from the principle of free trade and equality of opportunity—for example, through the granting of special subsidies to agriculture. In an insecure and tense world, preoccupied with cold-war strategy and defense considerations, the tendency is, in many ways, more strongly towards the Soviet principle than towards free trade.

As for the relations between private traders and state traders—at least those state-trading nations that are politically divided from the private-trade nations—international economic relations are likely to develop, if at all, on the basis of *quid pro quo*.[38] In fact, only one state-trading nation (Czechoslovakia) is a party to GATT, and "no one as yet has been able to envisage a way in which to extend the specific commitment system of purchases to the multilateral level."[39] Any retention of the most-favored-nation clause in relations between state-trading nations and others has political rather than economic significance. It emphasizes the principle of equality of opportunity.[40] But the actual trade relations between such states will be governed by specific agreements for the purchase and sale of fixed quantities of goods.[41] Such agreements, however, mean inevitably, for the purposes of the bilateral agreement, a departure of the private-trading states from their professed standard. To the extent that a state commits itself to the purchase or sale of certain quantities of goods, it abandons the principle of free trade—and of private enterprise—even though it may fulfill the agreement through subcontracting. In so far as it is possible to restore at all the equilibrium of international obligations in the trading

[36] Economic Commission for Europe, U.N. Doc. No. E/ECE/270, pt. 1 (1957).

[37] See the arguments as reported by Hazard, *Commercial Discrimination and International Law,* 52 AM. J. INT'L L. 495 (1958).

[38] Although the Finnish-Soviet treaty of 1947 contains the most-favored-nation clause, the really important provision is that "the Government of the Contracting Parties will from time to time enter into negotiations for the purpose of concluding agreements defining the size and charter of mutual delivery of commodities. . . ." Art. 1.

[39] Domke & Hazard, *State Trading and the Most-Favored-Nation Clause,* 52 AM. J. INT'L L. 55, 68 (1958).

[40] See Schwarzenberger, *The Most-Favored-Nation Standard in British State Practice,* 22 BRIT. YB. INT'L L. 96, 113 (1945); ROBERT R. WILSON, THE INTERNATIONAL LAW STANDARD IN TREATIES OF THE UNITED STATES 246 (1953).

[41] *Cf.* SEYID MUHAMMAD, *op. cit. supra* note 26, at 240.

relations between state-trading and other states, it can happen only by the acceptance of obligations incompatible with the principles of free enterprise.

The difficulties of maintaining an equilibrium of rights and obligations, or even a comparable meaning of concepts, such as "commercial and financial considerations" or "most-favored-nation treatment" between states of basically different economic organization are likely to lead to an increasing disintegration of universal trading agreements and a corresponding intensification of trade relations between more compact groups of states linked by common interests and principles.

V

Some Practical Devices for Bridging the Gap Between State Traders and Private Traders

As we have seen, it is unlikely that a general and multipurpose agreement, such as GATT, can provide more than a theoretical bridge between the diverging principles and policies that govern the planned economies, on the one hand, and the more or less private economies, on the other. The principle of nondiscrimination may apply in form, but not in substance. Where state-trading enterprises form part of a mixed economy, as they do in the majority of Western countries, it is possible to fit them into a general scheme of nondiscriminatory trading. As we have seen, a more determined modification of the traditional principles of government immunities and a more enlightened interpretation of the status of government-trading corporations would go a long way towards eliminating present inconsistencies and injustices. Given the elimination of such inconsistencies, it does not matter greatly whether the Italian shipping lines are operated by a government-controlled company or a privately-controlled company. Neither does it make any legal difference whether the—legally fully liable—National Coal Board of Britain or a private colliery sells or buys coal abroad. The decisive groupings in international trade are more and more directed by principles of politics rather than economics. While, on the one hand, a Sino-Soviet trading bloc is developing, in which trade circulates mainly within the bloc, with only relatively marginal trade taking place outside it, similar developments are, more tentatively, taking shape in the non-Communist world.

The counterpart to the Sino-Soviet trading bloc, whose members all regard trade as an adjunct of state policy, is not so much GATT as the evolving European Economic Communities. In the first of these, the European Coal and Steel Community, a joint supranational authority, controls and supervises the conditions under which trade in coal and steel flows between the participating industries. Certain strains have resulted from the fact that some of them are publicly and others privately-owned. In the second, the European Atomic Energy Community (Euratom), the Commission exercises managerial and operating as well as regulatory functions. In the third and most ambitious, the Economic Community, the Commission super-

vises, above all, the implementation of the free-trade and investment provisions. In all of them, a strong community of political purpose and economic organization is the indispensable prerequisite. Beyond the more closely-knit West European Communities, there are the looser ties between a wider circle of Western states, through the Organization of European Economic Cooperation (OEEC) and the as yet open, evolving Free Trade Area, which would comprise the West European Community of the six states and the wider group of OEEC nations.

Outside these evolving groupings of states, which are directed primarily by political rather than economic considerations, contacts and tensions between state-trading organizations and private traders are likely to arise mainly in the field of international investment, where industrially-developed countries confront either the government or a state-controlled organization of the capital-importing countries. Such is the case in a majority of the underdeveloped states which are now striving for rapid industrialization—states such as India, Burma, Ghana, Egypt, or Israel. In this group, there are also a number of Latin American states, where the government controls basic industrial and commercial developments, as it does, for example, in Brazil and Mexico. In all these states, the government plays a considerable and, in some cases, a decisive part in the economic process. In some states—*e.g.*, India—certain vital industries are reserved to the "public sector," and they are, therefore, owned and operated directly or indirectly by the government. In many countries, credit and finance are largely in the hands of public development corporations.[42] In other countries, notably in most of the oil-producing Arab states, the government is still largely identical with an autocratic ruler. In all these situations, economic transactions, of investment, production, trading, can only be placed on a satisfactory basis by specific treaties or agreements of a mixed public-private character. One model is provided by the series of recent friendship, commerce, and navigation treaties concluded by the United States with a number of countries, and typically providing for the principle of national treatment with respect to engaging in business activities and all the ancillary operations.[43]

In so far as activities, because of national sensitivities, are excluded from the national treatment principle, the most-favored-nation treatment ensures a status at least

[42] Such as the Nacional Financiera of Mexico, which also directly participates in industrial enterprises.

[43] A typical clause, as first formulated in the treaty of 1949 between the United States and Uruguay, S. EXEC. D., 81st Cong., 2d Sess. art. 8, para. 1 (1950) is as follows:

"Nationals and companies of either Party shall be accorded national treatment with respect to engaging in all types of commercial, industrial, financial and other business activities within the territories of the other Party, whether directly or by agent or through the medium of any form of lawful juridical entity. Accordingly, such nationals and companies shall be permitted within such territories: (a) to establish and maintain branches, agencies, offices, factories and other establishments appropriate to the conduct of their business; (b) to organize companies under the general company law of such other Party, and to acquire majority interests in companies of such other Party; and (c) to control and manage enterprises which they have established or acquired. Moreover, enterprises which they control, whether in the form of individual proprietorships, companies or otherwise, shall, in all that relates to the conduct of the activities thereof, be accorded treatment no less favorable than that accorded like enterprises controlled by nationals and companies of such other Party."

as favorable as that enjoyed by other aliens.[44] Equally important for the encouragement of relations between private enterprise and governments are the clauses in the same type of treaties that guarantee the property of foreign subjects against expropriation, "except for public purpose," and promise "prompt payment of just compensation."[45]

For further attempts to bridge the gap, we must look to a variety of bilateral agreements made for a specific purpose. To quote but one example, some years ago the Indian Government entered into three parallel agreements with major foreign oil companies for the construction of oil refineries in India—which are, in principle, reserved to the public sector. In these agreements, the Indian Government gave certain promises for import of the necessary raw materials and other facilities for marketing, exchange, etc. It also promised that it would not expropriate the enterprise for a period of twenty-five years and that there would be "reasonable compensation" in case of any expropriation thereafter.

We shall also have to look at the large number of bilateral concession agreements between a sovereign government and a foreign investor for the slow and halting development of international legal principles governing international investment. The first—and cardinal—principle—yet far from established—is that agreements between a government—or a government-controlled corporation—and a foreign private investor should come to be controlled by firm legal principles, modeled on the general principles of law—and, in particular, of contract—as recognized by civilized nations. This would be part of the increasing blending between public law and private law in the field of international economic transactions. This matter is still obscured by insistence on the principle of national sovereignty, which should come to be held as inapplicable to the field of agreements in the area of foreign investment for economic purposes as it should come to be outmoded in the area of government immunities.

Here, as in the other areas which we have briefly surveyed in this article, it must be recognized clearly that for many years to come, international society will display a vast variety of forms of economic and social organization, ranging from the complete control of all economic activities to systems dominated by private enterprise and trade. Unless there is to be a complete severance of ties between diverse groups of nations, a severance which would increase the already vast political schism, working compromises must be found; and the only rational basis for such compromises can be equality of treatment and status for the purpose at hand. This means that government and private enterprise must, for the particular investment transaction or litigation, meet, as far as possible, on a plane of equality. Such equality implies that,

[44] For a survey and analysis of the friendship, commerce, and navigation treaties, see Walker, *Treaties for the Encouragement and Protection of Foreign Investment: Present United States Practice*, 5 AM. J. COMP. L. 229 (1956).

[45] As for the effectiveness of nonexpropriation promises in international law, reference must be made to the vast literature on the subject. See, *e.g.*, Fatouros, *Legal Security and International Investment* in W. FRIEDMANN & R. C. PUGH (EDS.), LEGAL ASPECTS OF FOREIGN INVESTMENT 699 (1959).

on the one hand, governments charged with duties of abstention—as in the law of neutrality—must not seek refuge behind the assertion that they cannot control private trade—an assertion which would in any case be hypocritical in modern conditions; and, on the other hand, governments should not be accorded privileges in relation to private traders because of the identification of their trading enterprises with the state.

We need a far clearer separation than has hitherto been evolved between the legitimacy of economic state activities as a function of government and the submission of government-trading activities to the ordinary legal processes of full liability and accountability. Where government and private enterprises meet for a particular purpose, as in the development of a new utility or industry in an underdeveloped country, they can iron out the differences, either in the framework of a basic treaty that ensures national treatment and protects against discriminatory interference with property, or through a specific *ad hoc* agreement, such as is contained in modern concessions. In other words, international law and relations in this field can develop mainly in a series of *ad hoc* compromises, out of which, in time, a general body of principles of international economic law may evolve, compounded of the traditional principles of public international law and the principles that have been shaped in the private law of contracts, tort, and property.

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